Supreme Court of the United States

..... Term.

No. .....

PHILIP SMOLOWE and M. WILLIAM LEVY, suing on behalf of themselves and as stockholders and for the benefit of all other stockholders of DELENDO CORPORATION similarly situated who may elect to come in and contribute to this action,
Respondents-Appellees,

against

DELENDO CORPORATION (formerly OLDE-TYME DISTILLERS CORPORATION), I. J. SESKIS and HENRY C. KAPLAN,
Defendants-Appellants.

UNITED STATES OF AMERICA,
Intervenor-Appellee.

PETITIONERS' BRIEF

Delendo Corporation (hereinafter referred to as "Delendo") and its president and vice-president (the appellants, Seskis and Kaplan, respectively)—who were also two of Delendo's directors—apply for a writ of certiorari to the Circuit Court of Appeals for the Second Circuit, to review a decree of said court (SWAN, CHASE and CLARK, Circuit Judges), affirming a judgment of the District Court for the Southern District of New York (BRIGHT, *D. J.*), which, in a derivative stockholders' action, brought under § 16b of the Securities Exchange Act of 1934, adjudged that Delendo recover from the appellant, Seskis, $9,733.80, and, from the appellant, Kaplan, $9,161.05, plus costs as

taxed, and awarded plaintiffs' counsel a fee of $3,000, plus expenses—in all, $3,078.98 (R., pp. 120, 121).

In each instance, the judgment was predicated on a finding that the individual defendants had "realized" "profit" to the extent indicated, from sales and purchases, within a period of six months, of their holdings of stock in Delendo, the acquisition as well as the sale of which, was each quite proper and did not invade Delendo's field of activity or violate any duty owing to it. In fact, there was an express and explicit finding that both Seskis and Kaplan had acted in good faith, and had not committed any act in violation of their fiduciary obligations to Delendo (fols. 365, 133, 187). Furthermore, there was not and could not be any finding that Delendo had suffered any damage or injury.

Opinions.

There was an opinion by BRIGHT, *D. J.* in the District Court. It is reported in 46 F. Supp. 758. It will be found in the record at pages 69 to 84, inclusive.

There was an opinion in the Circuit Court of Appeals by CLARK, *J.*, which has not yet been reported. It will be found in the record at pages 127 to 145, inclusive.

Jurisdiction.

The basis of jurisdiction is set forth in the petition preceding this brief, at pages 3-4.

The Statute.

The explanation for the judgment is to be found in the supposed command of the statute (printed at p. 10, *infra*).

Appellants' Contentions.

We contend that the learned courts below misconstrued the statute, which had no purpose to penalize anything but transactions, within six months, predicated on the use of inside information, nor to embrace transactions which

originated before the statute went into effect; and disregarded the words "profit *realized,*" as used in the statute, so as to nullify their plain meaning, with the result that unrelated transactions were juxtaposed to produce a fictitious profit; furthermore, that, in so doing, the court followed one of two draft bills, both of which were disapproved by the Congress, and thus substituted its own views of expediency for the judgment of the Congress, as unmistakably evidenced by its enactment.

This process is reflected in the opinion of the Circuit Court, as we shall point out, as we proceed with our argument.* The chief difficulty with the opinion of the Circuit Court is that instead of seeking only the intention of Congress, as evidenced by its enactment and its legislative history, the court permitted itself to be diverted to considerations of expediency, which were not open for judicial review, because they had been considered and passed upon by the Congress, and that in so doing, it was influenced more by learned but irresponsible commentators than by the authentic emanations from the Congress itself. (Witness the unusual degree of reliance upon law review articles exhibited in the footnotes, and compare differing speculations of Yourd and Seligman.)

We contend, further, that, if the court's construction of the statute is deemed correct, the statute is invalid, under the Constitution of the United States, upon the specific grounds, and in violation of the specific provisions, set forth in appellants' answer (fols. 24-32, 109—Specifications of Error, *infra,* p. 7).

Finally, we contend that, in any event, since no substantial benefit was or could be conferred on the corporation, plaintiffs' counsel should not have been awarded any fee at all, or at the most, only a fee predicated on the distributive shares of the plaintiffs stockholders, which would be so inconsequential, as not to justify any fee at all.

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* References to the opinion of the Circuit Court will be to the pencilled numbers identifying the pages of the printed opinion bound into the official transcript of the record, submitted herewith.

The Facts.

We do not enlarge upon the facts. There was not, and is not now, any issue as to them. They are succinctly stated in the stipulations of the parties (R., pp. 40-63). Enough, therefore, to emphasize the salient points.

The six-month period upon which the complaint rests, begins on December 1, 1939, and ends on June 1, 1940 (fol. 115).

The stock transactions upon which plaintiffs count, were of miscellaneous character.

As to the defendant Seskis: on the acquisition side, only 584 shares were acquired through purchases made on the Curb Exchange (Ex. 2, par. 17, fol. 167), whereas the balance of 14,920 shares was a private purchase—without the intervention of either Exchange or broker—from the Distillers & Brewers Corporation of America (Ex. 2, par. 15, fol. 165). But, on the disposition side, none of the transactions was a sale in the ordinary sense of that term. On the contrary, there was only one transaction—and that involving 15,800 shares—which was a delivery of stock by defendant Seskis in partial liquidation and payment of an antecedent indebtedness to the defendant Kaplan (Ex. 2, par. 19, 20, fols. 169-170).

As to the defendant Kaplan: All of his acquisitions (other than the above mentioned 15,800 shares acquired from Seskis) were accomplished through purchases on the Curb Exchange (Ex. 2, par. 21, 23-27, fols. 173-179), and all of his dispositions (here material) were also accomplished through sales on said Curb Exchange (Ex. 2, par. 28, fols. 181-183).

No analysis of the evidence in this case, would be complete, however, without further inquiry as to the date of acquisition, by the defendants Seskis and Kaplan, of the shares of stock, which they sold, and inquiry as to whether what was purchased within the six-months' period, was sold, ***within that period.***

Defendant Seskis, in the six-month period in question, was the owner of approximately twelve per cent of the

stock of the corporation, representing approximately 96,000 shares (Ex. 2, par. 7, fols. 159-161). Deducting from said 96,000 shares, the total number of shares represented by the acquisitions in said six-month period, i. e., 15,504 shares (Ex. 2, par. 15, 17, fols. 165, 167), it follows that the defendant Seskis had, prior to said period, at least 80,496 shares.

Similarly, the defendant Kaplan, in the six-month period in question, was the owner of approximately twelve per cent of the stock of the corporation (Ex. 2, par. 8, fol. 160). Therefore, making a similar deduction for him, as to the number of shares acquired in the six-month period, i. e., 22,900 (Ex. 2, par. 20, 21, 23-27, fols. 170-179), it follows that the defendant Kaplan, prior to the six-month period, owned 63,100 shares.

What defendant Seskis transferred, in the six-month period, was, to the extent of 11,300 shares, stock which he acquired on August 3, 1934 (Ex. 2, par. 20, fol. 171), i. e., two months before the effective date (October 1, 1934) of the Securities Exchange Act of 1934; and, to the extent of the remaining 4500 shares, stock which he had acquired on May 4, 1937 (Ex. 2, par. 20, fol. 171), i. e., three years before the six-months period in question.

What defendant Kaplan sold, in the six-months period, was, to the extent of 4300 shares, stock which he had acquired before the commencement of that six-months period. Only as to the remaining 1700 shares, did purchase as well as sale of the same shares, occur within the six-months period (Ex. 2; cf. par. 22, 23 and 26 with par. 28, fols. 173, 174, 178, 181-183).

It is important to note, in connection with these transactions, that both the District Judge and the Circuit Court of Appeals were able to find "profit realized," only by failing to identify and correlate transactions of purchase with transactions of sale of the same stock. Instead of matching the sales and purchase phases of the same stock transactions, they arbitrarily matched sales and purchases, within the six-months period, even though involving different stock transactions. This, as we shall show, constituted

a nullification of the explicit phraseology of the statute—no matter what else may be thought of its construction or validity. If the learned Courts below had matched the sales and purchase phases of the same stock transactions, they would have been bound to conclude that, instead of "profit realized," there was no profit at all, in the case of Seskis, and a profit of only $23.91 in the case of Kaplan (*infra,* pp. 50-51).

Furthermore, it has been stipulated, both by plaintiffs and by the Government, that they "do not and will not contend that any of the foregoing facts establish that the individual defendants or either of them acted in bad faith with respect to any of the foregoing transactions, i. e., in acquiring or selling the stock in question, nor that they or either of them unfairly used any information which was obtained by them or either of them with respect to any of the foregoing transactions" (Ex. 1, par. 8, fol. 133; Ex. 2, par. 33, fol. 187). Defendants did not employ any inside information, in the purchase or sale of their stock. On the contrary, there were no purchases in the period when such information as there was (fol. 131) might have been useful to scheming minds, in acquiring stock which would later bring them substantial profits.

The opinion of the Circuit Court of Appeals is not quite accurate as to these phases of what occurred:

So, it is not correct to say that "negotiations with Schenley's were *reopened* on April 11th * * *" (R., p. 129). The prior negotiations, for the sale of the corporation's assets to Schenley were never "reopened." The stipulation in the record, on this point, reads: * * * the ensuing negotiations had no connection whatsoever with the said prior negotiations, and were without prior suggestion by Delendo or Schenley, or any of the defendants, or any officers or directors of Delendo or Schenley" (fol. 131); furthermore, "No negotiations were pending between January 1936 and April 11, 1940" (fol. 132); the prior "negotiations resulted in nothing, and were terminated in January, 1936 * * *" (fols. 126-127).

Furthermore, though the Circuit Court points out that

all of defendant Kaplan's purchases were made "prior to April 11, 1940" (R., p. 130)—which was the date on which negotiations with Schenley, for the acquisition by it of the corporation's assets, were commenced (fol. 131)—a different impression may be gained from the court's discussion of the defendant Seskis' purchases. For, with respect to defendant Seskis, the Circuit Court states that he made his purchases "during the six months here in question from December 1, 1939, to May 30, 1940" (R., p. 129). The fact is that the defendant Seskis' last purchase was on February 28, 1940, and that he did not make any purchases whatsoever from that date—including the significant date of April 11, 1940—to May 30, 1940 (fols. 165-166).

Plaintiffs' case and the Government's contentions, therefore, rest upon a showing, not of any bad faith, nor of any use of inside information, but upon supposed, but unproved opportunities therefor, which might have been availed of, but were not—in fact, did not exist.

Specification of Errors.

The errors alleged are with respect to the construction of the statute, as well as to its constitutional validity:

1. The Circuit Court of Appeals erred in holding that the Congress intended to exclude consideration of the undisputed fact, that inside information was not used by the defendants or either of them, and, therefore, in making defendants' liability absolute, irrespective of the fact that there was not any use of inside information.

2. The Circuit Court of Appeals erred in holding that when the Congress provided that "profit realized" should be recoverable, it did not contemplate a comparison of sales and purchases or purchases and sales of the same stock, according to the rules applicable in computing income taxes.

3. The Circuit Court of Appeals erred in holding that the Congressional enactment has application to transactions, the purchase phases of which antedated the effective date of the statute.

4. The Circuit Court of Appeals erred in holding that the delivery by the defendant Seskis to the defendant Kaplan of 15,800 shares, in payment of an antecedent indebtedness owing by Seskis to Kaplan, is not to be deemed beyond the operation of the statute.

5. The Circuit Court of Appeals erred in holding that the Congressional enactment as construed by it did not deprive defendants of property without due process of law, in violation of the Fifth Amendment to the Constitution of the United States.

6. The Circuit Court of Appeals erred in holding that the Congressional enactment, as construed by it, did not constitute an unauthorized delegation of legislative power to the Securities Exchange Commission, in violation of § 1 of Article I and Paragraph 18 of § 8 of Article I of the Constitution of the United States, directly affecting defendants.

7. The Circuit Court of Appeals erred in holding that the Congressional enactment as construed by it did not constitute an unauthorized invasion into transactions which are not part of interstate commerce as contemplated by Clause 3 of § 8 of Article I of, and the Tenth amendment to, the Constitution of the United States.

8. The Circuit Court of Appeals erred in holding that the District Court was authorized to make allowance of counsel fees, as directed by the judgment of the District Court.

ARGUMENT.

SECTION I.

(Treating of Construction of the Statute.)

POINT I.

The statute excludes only the inquiry as to whether a short swing was intended. It does not exclude consideration of, nor deny decisive materiality to, conclusive evidence—such as there is in the case at bar—that, in fact, defendants did not use any inside information. It is not the use of inside information alone, nor any short swing alone, which is declared to be unfair, but the use of inside information accompanied by a "short swing," within six months.

This is shown by an analysis of the statute, a consideration of its history, and a comparison of it with the prior drafts.

A study of these materials will show conclusively that what the Circuit Court of Appeals did, in purporting to construe the statute, was to disregard its plain command, and to adopt one of two recommendations, both of which, after mature consideration, were disapproved by the Congress.

In the following quotations, the bracketed numbers, e. g. **[1]** are not a part of the statute as enacted, but merely our own symbols for convenience of reference in our subsequent discussion. Similarly as to the bracketed symbols, e. g. **[S1]** in the Senate Bill or **[H1]** in the House Bill.

The Statute as Enacted.

§ 16(b)—Securities Exchange Act of 1934, 15 U. S. C. A. § 78p(b).

"Directors, Officers, And Principal Stockholders

* * * *

[1] "(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, [2] any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, [3] irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. [4] Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. [5] This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or [6] any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Draft Bills.

HOUSE BILL 8720.
(insofar as it is material)

[H1] Any profit realized by such beneficial owner, director, or officer from any purchase and sale or sale and purchase of any such registered equity security within a period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, [H2] irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months * * *. [H3] For the purposes of this subsection the profit shall be the difference between the ***aggregate amount*** for which such security was purchased and sold during the six months' period ***irrespective of the certificates for such security received or delivered pursuant to such purchases and sales.***"

"*Transactions by Directors, Officers, And Principal Stockholders*
Sec. 15.

* * * *

[S1] (b) It shall be unlawful for any director, officer or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—
[S2] (1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and [S3] any profit made by such person on any transaction in such a registered security extending over a period of less than six months shall inure to and be recoverable by the issuer, [S4] irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months. [S5] Such suit may be instituted in law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter. [S6] *For the purposes of this subsection the profit shall be calculated on the sale or sales by such person of such security made at the highest price or prices and on the purchase or purchases made by such person of such security at the lowest price or prices during the six months' period,* [S7] ***irrespective of the certificates for such security received or delivered by such person during such period.***
[S8] (2) To sell any such registered security, if the person selling does not own the security sold or if the person selling owns the security but does not deliver it against such sale within five days;
[S9] (3) To disclose, directly or indirectly, any confidential information regarding or affecting any such registered security not necessary or proper to be disclosed as a part of his corporate duties. [S10] Any profit made by any person, to whom such unlawful disclosure shall have been made, in respect of any transaction or transactions in such registered security within a period not exceeding six months after such disclosure shall inure to and be recoverable by the issuer unless such person shall have had no reasonable ground to believe that the disclosure was confidential or was made not in the performance of corporate duties. [S11] Such suit may be instituted in law or in equity in any court of competent jurisdiction by the issuer or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter. [S12] *For the purposes of this subsection the profit shall be calculated on the sale or sales by such person of such security made at the highest price or prices and on the purchase or purchases made by such person of such security at the lowest price or prices during the six months' period* [S13] ***irrespective of the certificates for such security received or delivered to such person during such period.***"

Now, it will be observed, from these draft bills—which were *not* enacted—that they differed from the statute as enacted, in the following important respects, each of which will become material as we proceed with our discussion:

1. Whereas the Senate Draft made it unlawful [S1] "to purchase * * * with the intention or expectation of selling * * * within six months" [S2] the Congressional enactment eliminated the criminal sanction, inserted a definition of purpose "of preventing the *unfair* use of information" [1] but still made immaterial *only* the "intention" of "holding" the security [3]. Significantly, there is lacking any statement that it shall be immaterial whether inside information was or was not used. On the contrary, it is still contemplated that only the "unfair" use of information creates liability, and that what makes such use "unfair" is its *employment* in connection with a "short swing." Indeed, the effect of inserting the definition of purpose, i. e., to prevent the "unfair" use of information, was unquestionably to make "intention" of "holding" the stock immaterial only if inside information was used. Otherwise a "short swing" would not be "unfair," nor would it have been specified that only "intention" of "holding" the stock should be immaterial. There was thus a substitution of an objective for a subjective inquiry, i. e., the issue became as to whether there was use of inside information in connection with a "short swing," instead of as to what was the "intention" in making it.

2. The profit which was required to be disgorged —formerly required both, by the Senate and House Bills, to be calculated "irrespective of the certificates" ([S7], [S13]), and, by the Senate Bill as to sales, at the "highest prices," and, as to purchases, at the "lowest prices," in the six-months period ([S6] and [S12]) or by the House Bill, by the difference between "aggregate" sales and "aggregate" purchases [H3]—was, by omission of such standards as theretofore contained in the Senate and House drafts, and by express phraseology of the statute as enacted, required to be measured by the actual effect of the transaction, at actual prices,

i. e., the "profit realized" [2]. And concomitant with that fundamental change—and made possible by it—a two-year statute of limitations "after the date such profit was *realized,*" was introduced [4] for the first time (cf. [S5], [S11]).

3. The former prohibitions against third persons employing inside information ([S9], [S10], [S11], [S12] and [S13])—not contained in the House draft—were eliminated from the Senate draft and the statute enacted to operate only as against representatives and beneficial owners, i. e., officers, directors or 10 per cent stockholders [1].

4. Whereas the Senate draft made it unlawful only to "purchase" [S2] on a short swing, and prohibited "short" sales altogether [S8], the statute as enacted contemplated both sales and purchases [2] but instead of making them unlawful, appropriated to the corporation, the "realized profit," in the case of transactions, in which inside information was used on a short swing within six months.

5. Whereas the Senate draft furnished a definite standard to which there were no exceptions, the statute as enacted actually delegated to the Securities and Exchange Commission the legislative function of making exceptions (in addition to those contained in the statute) as said Commission saw fit [6].

Accordingly, it is indisputable that the Congress in enacting what is now section 16b, disapproved and eliminated material portions of the bills as drafted and recommended and made radical changes—a decisive fact, which both the District and Circuit Courts entirely overlooked. So as to the measurement of profit, the Congress rejected both the "lowest vs. highest" formula proposed in the Senate, as well as the "aggregate" formula proposed by the House, and instead adopted the principle of actual "profit *realized*", in new phraseology not appearing in the Senate Bill but appearing in the House Bill [H1]. But the Circuit Court disregarded the phraseology of the statute as enacted, and for itself chose to reject the House formula, and to

accept the rejected Senate formula. Judicial legislation, if there ever was any! For if the Circuit Court was authorized to approve the rejected House formula and to accept the rejected Senate formula, we suppose that, by the same standard, it could have adopted the rejected House formula, and disapproved the rejected Senate formula. Indeed having taken "profit realized" from the House Bill [H1] it could be more plausibly argued (though with equal lack of conviction) that it was the House formula, which was intended.

The Statute Considered.

A statutory definition of the limits of its scope is not to be dismissed as a mere "preamble," and its most significant word of limitation "unfair" exscinded altogether, as was done by the learned Courts below. (*Phelps Dodge Corp.* v. *Labor Board,* 313 U. S. 177, 182, 209; *Fashion Guild* v. *Trade Commission,* 312 U. S. 457, 465.)

A fortiori, when, as here, it is not an introductory preamble, but a congenitally integrated definition of the purpose and scope of the specific prohibition against the use of inside information for "short swings"—a practice which is declared to be *ipso facto* unfair.

For, under no circumstances can the statement of purpose and scope, embraced within § 16-b, be deemed a mere preamble as it is described in the opinions of both courts below (R., p. 75 and p. 131). The preamble to the statute is to be found not in § 16b, but in § 2 (15 U. S. C. A., § 78-b). We quote the material portions of that preamble, not only to distinguish it from the definition contained in section 16b, but, also, as a basis for considering the true purpose of that provision, i. e., not to prevent investments by fiduciaries in the stock of their corporation, but only short-swing speculations, which are deemed to be "unfair". It does not require demonstration to this court that it is the American policy of corporate management that a corporation's managers shall be substantial stockholders, and that, accordingly, not only is it blameless for a fiduciary to hold stock in a corporation, but praiseworthy that he should do

so. It was not intended that those who knew the affairs of the corporation best, should be discouraged from making *investments* in its stock. It was intended only that those who were in a position to have inside information, should not use it for the purpose of unsettling the market on speculative short-swings. It is only in the light of the mischief to be remedied and the "reason of the enactment" and its "antecedent history" that construction of the statute may be surely made "according to its design and purpose," (*Ozawa* v. *U. S.*, 260 U. S. 178, 194). That such was the sole purpose of the statute, i. e., not to prevent the use of inside information generally, but only in connection with speculative "short swings," appears clearly from what is really the preamble to the entire enactment (including section 16-b) whom which we quote only the portions material to our discussion, as follows:

"§ 78b. Necessity for regulation

For the reasons hereinafter enumerated, transactions in securities * * * are affected with a national public interest which makes it necessary to provide for regulation and control * * * and to insure the maintenance of fair and honest markets * * *:

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities * * *.

(4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit."

Accordingly, the remarks of the learned Courts below, characterizing the integrated, definitive statement of scope and purpose incorporated within § 16-b, as a mere "pre-

amble," and disregarding its use of the word "unfair," contained in it, are quite unfortunate. They lead to the absurd result that the statute is deemed to contain a preamble within a preamble instead of a statement of purpose as to a particular sanction, carrying out the general preamble. If said integrated, definitive purpose is to be described in anatomical terms, as suggested by the learned District Judge (fol. 223), then it is not "a preamble * * * to the 'teeth' in the section," but one of the "teeth" themselves. For the word "unfair" as used in the statute's statement of purpose, describes the motivation of what is prohibited by the decretal portions of the statute, i. e., the use of inside information by fiduciaries, not generally, but for *short swings*. It is in that connection that what is made immaterial is not whether there was fair or "unfair," use of information, in connection with a short swing, but only whatever may have been the "intention" of the beneficial owner in "holding" the stock.

So the portion, identified by the figure [1] states the purpose of the enactment, but it is the decretal provision [3] which circumscribes the appropriate area for its enforcement, i. e.: The purpose was to prevent "the *unfair use of information which may have been obtained by such beneficial owner, director, or, officer by reason of his relationship to the issuer* * * *." To implement that purpose, it was decreed that a "short swing" was to be deemed unfair ***"irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period of six months."*** The word "unfair," must not be eliminated, in the process of construction. Not all use of inside information was prohibited, but only the "unfair" use thereof. Such use became "unfair" only when employed in connection with a "short swing." Such only was the use interdicted by the decretal clause: ***"* * * irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased * * * for a period exceeding six months."*** The latter clause is the sole implementation of the stated purpose. For the inquiry is as to whether any inside information was used *followed by a sale or purchase within*

six months. If it was, the statute prescribes that such use shall be deemed unfair, irrespective of any intention to hold the stock for six months or to replace it within that period. If, as in the case at bar, there was neither such information, nor use thereof, the statute has no application at all. Otherwise, the very definition of what is intended to be prohibited by the statute, i. e., the "unfair" use of "information which may have been obtained * * * by reason of his relationship to the issuer * * * irrespective of any intention * * * of holding the security purchased for a period of six months,"—declared to be *ipso facto* "unfair"—is exscinded from the statute altogether, and a broad and vague statement of purpose, emasculated by excision of the word "unfair," permitted to submerge the only interdiction which the Congress made to effectuate that purpose.

Accordingly, the whole point of the problem of construction, in this phase, is this: For the statutory command implementing its characterization of what is to be considered the "unfair" use of inside information, we look only to the matter identified by the figure **[3]**: "irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction *of holding the security purchased or of not repurchasing the security sold for a period exceeding six months.*" It was such "intention" and only such "intention" which was made immaterial.

Such decretal provision is not a statement that it shall be immaterial whether inside information was or was *not* used, but only that if it should appear that inside information *was* used, it shall be immaterial as to whether it was the "intention" on the part of the fiduciary "*of holding the security* for a period exceeding six months" or of refraining from replacing the stock within six months. Obviously, the intention of the corporate fiduciary as to the period in which he would continue to hold stock purchased, or replace stock sold, could be material only in an inquiry as to whether he was engaged in a speculation on a "short-swing." For every other purpose, existing equitable prin-

ciples governing the conduct of fiduciaries, were quite adequate. This fact was overlooked by the Circuit Court which seemed to think that the enactment, instead of merely supplementing, in fact, supplanted existing remedies (*infra*, p. 35). Besides, as appears from what is really the general preamble (§ 78-b, *supra*, p. 15) the federal government's sole legitimate interest was in the effect accomplished in stabilizing honest markets for the stock. Prior to the statute, it was not unfair or actionable to use "inside information" even for a short swing (see authorities, *infra*, pp. 58-62). The purpose of the statute, however, was to create not a substituted, but a new and additional standard as to the use of "inside information" on short swings, and by prohibiting the same, to eliminate purely subjective considerations, *as to an intention to execute short swings*, which was difficult of proof, and, therefore, to exclude inquiry into that nebulous field of undisclosed intention *as to holding the stock* or replacing it. It was not the purpose of the statute to penalize a transaction in which there was not any use of inside information at all or to eliminate the objective inquiry as to whether inside information was actually used. In other words: If inside information was "used," with a "short swing" as a concomitant, it was immaterial what were the fiduciary's intentions when he originally purchased or sold the stock as to "holding" the stock. That there had been use of inside information, in sale and purchase, or purchase and sale of the same stock, accompanied by a "short swing" within six months, made it utterly immaterial whether the motivation for the transaction was *investment*, or a "short-swing"—so ephemeral, under such circumstances, was the distinction deemed to be. But all of this predicated upon the actual use of inside information in connection with a "short swing"! It was not the use of inside information which was rendered actionable, but the use of such information accompanied by a "short swing" within six months.

That such was the result intended by the Congress, will appear from a comparison of the enacted statute with the prior drafts of the statute, which failed of enactment. For

under the Senate draft, the purchase of stock "with the intention or expectation of selling the same security within six months" [S2] by officers, directors or beneficial owners —was altogether prohibited and made unlawful [S1], but under the statute as enacted only transactions predicated on the "unfair" use of inside information *in connection with a short swing*— though not made unlawful, were penalized by having the "realized profit" from such "unfair" transactions, appropriated to the corporation. But, if the "swing" took seven months, instead of six months, there was no liability at all. The enacted statute—following in this respect both the Senate and House drafts—did no more than make it immaterial what was the real "intention" as to "holding" the stock (cf. [3], [S4] and [H2]. Use of inside information in connection with a "short swing" was *ipso facto* unfair.

And reference to the legislative debates in Congress—to which we have a right to look for such light as they may afford (*U. S.* v. *Dickerson,* 310 U. S. 554-562; *Maxwell* v. *Dow,* 176 U. S. 581, 601-602; *Downs* v. *Bidwell,* 182 U. S. 244, 254; Legal Tender cases, 110 U. S. 421, 444) indicate that such was the only limitation which Congress intended, i. e., to cases in which inside information was used, accompanied by a "short swing" within six months, irrespective of actual "intention" as to "holding" the stock.

The Senate and the House drafts of this legislation did not contain the present statutory, integrated and self-defining statement of purpose and scope [1]. But both did contain the same "irrespective" clause, exactly as contained in the enacted statute (cf. [3], [S4], [H2]) that any profit made on any transaction in such a registered security extending over a period of less than six months shall inure to and be recoverable by the issuer, "irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months."

Now, it will be observed that the Senate bill had this in common with the statute as enacted: Both made it immaterial to inquire as to "any intention", on the part of a beneficial owner, director, or officer, in "entering

into such transaction of holding the security purchased" for "a period exceeding six months" (cf. [3] [H2] and [S4]). However, it should be remembered that the Senate draft concerned itself only with "the security purchased" [S2], whereas the House draft [H2] as well as the statute as enacted concerned themselves, also, with "repurchasing the security sold" [3]; furthermore, that, whereas the Senate draft embraced, within its scope, third persons receiving inside information from fiduciaries, the statute as enacted (following the House draft) eliminated such persons from the orbit of the statute altogether. Therefore, it is important to observe that references to the hearings before the Senate Committee (which references were made by the Government and by plaintiffs' counsel, below), will prove misleading (as they were indeed to the Circuit Court of Appeals) unless careful discrimination is made between what remains in the statute enacted and what was exscinded from the proposed Senate Bill.

So, what Mr. Corcoran was "graphically" discussing (opinion, R., p. 132) in the Senate Committee hearings—in the following excerpt which we take from those hearings—(and this is the oft-repeated quotation upon which the plaintiff's case rests and to which there is misapprehended reference in the opinion of the Circuit Court [R., p. 1498])—was only that portion of the statute as enacted, which retained the corresponding recommendation in the statute as proposed, i. e., that it should be immaterial, not as to whether inside information was used, but as to what was the intention or expectation to sell the security within six months after the purchase. Indeed, as we have seen, neither the Senate nor House drafts—like the statute as enacted—contained any prohibition against the use of inside information *simpliciter*. It was, therefore, that there was no "dissent" from the proposed objective standard of proof (opinion, R., p. 134). There was never any such suggestion as to use of inside information by insiders—only as to "intention" of "holding" the stock. It was with reference to the specific provision as to "intention"—and only with reference to that provision—that Mr. Corcoran said:

> "That is to prevent directors receiving the benefits of short term speculative swings on the securities of their own companies, because of inside information. The profit on such transaction under the bill would go to the corporation. You hold the director, ***irrespective of any intention or expectation to sell the security within six months after,*** because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short swing" (Hearings before Senate Committee, p. 6557).

But what was it that would be difficult to prove? Certainly, not that the corporate fiduciary used "inside information"! There was no such provision in the Senate Bill *as to officers, directors or beneficial owners,* nor in the House Bill,—any more than in the statute as enacted. It is an every-day occurrence in our courts, to have a demonstration of the use of inside information by insiders, succinctly made.

There can be no doubt that it was intended only to rule out any contention that the selling and buying phases of a stock transaction completed within six months, and predicated on the use of inside information, was intended not as a "short swing" speculation, but as a long term investment. For it was not the purpose of the statute to create a new general code for corporate fiduciaries, or to prevent investments, or even to prevent the use of inside information generally, but only to take the profit out of "short-swing" speculations based on the "unfair" use of inside information, in connection with a six months "swing."

Similarly, what Mr. Corcoran was discussing, in the following excerpt which we take from the hearings before the Senate Committee, was not the statute as we now have it, but the Senate draft [S10] far more radical and—in the respect to which Mr. Corcoran was addressing himself—quite different, in that, unlike the statute as enacted, it prohibited, and made criminal, the disclosure to *third persons* of inside information obtained by corporate directors or officers or ten percent stockholders. This appears from

the following colloquy between Mr. Corcoran and Senators Carey, Barkley and Gore:

> "Mr. Corcoran. Subparagraph (3) affects the friends to whom these corporation directors and officers and big stockholders pass on a tip that the stock is going up for a short swing, and through whom they may conceal their own operations, since the friend may be simply acting as an agent through whom the director, officer, or principal stockholder effects the transaction for his own benefit. The paragraph reads as follows [reading]:
>
> * * * *
>
> (3) [S9] ff. as printed on page 11, *supra.*
>
> * * * *
>
> Senator Carey. Suppose he did not say it was confidential, but said they had a good well coming in tomorrow, and this fellow went out and bought some stock?
>
> Mr. Corcoran. The person who is being sued by the company, if he can show that he had no reasonable ground to believe that the disclosure was confidential or was made not in the performance of corporate duties, would not be liable.
>
> * * * *
>
> Senator Carey. I do not see how you can determine when the information is confidential and when it is not.
>
> Mr. Corcoran. That would depend, sir, upon the nature of the business of the company and the nature of the information.
>
> Senator Carey. Suppose he said, 'I have a letter here today from our man out in the field, and I am certain from what he says that we are going to have a good well.' The man goes out into the market and buys.
>
> Mr. Corcoran. Whether that is a revelation of confidential information depends upon all the circumstances surrounding the case.
>
> Senator Carey. I think you are breeding a lot of lawsuits here" * * * (Senate Committee Hearings, pp. 6560-1).

The only difficulty envisaged upon this point, was *as to the use of inside information by third persons* to whom the corporate fiduciaries might disclose confidential informa-

tion. No such provision is to be found in the statute as enacted.

Indeed, there was no penalty, whatsoever, in the Senate draft, as to quasi-short sales (sales of theretofore acquired stock followed by purchases of an equivalent amount of such stock) nor was there any penalty as to real short sales, followed by delivery within five days, no matter what use there was of inside information by officers, directors or ten percent stockholders. On the contrary, the only difficulty contemplated was in showing that any of these individuals, when he ***bought*** the stock, intended to speculate in it "on a short-swing." Indeed, throughout the proceedings, there is not a single reference to a purpose to foreclose inquiry as to anything but the corporate representative's supposed "intention" to speculate—on a "short-swing"—in stocks acquired for resale. Not a thought of shutting off inquiry as to whether inside information was, in fact, used!

In the light of this history, it is plain that the provisions of the Senate draft, which are not found in the statute as enacted, were deliberately omitted, and should not now be made a part of it by any process of construction. The Congress refused to make it a crime to speculate in stock; but it took the profit out of a "short swing" based upon the use of inside information. And Congress expressed the statutory purpose to prevent, not the use of any and all information, but only the "unfair" use of inside information i. e. for "short swings," and made corporate representatives subject to that limitation while at the same time excluding third persons from proposed restrictions as to the use of "confidential" information. As recognized in the Senate Hearing Debates it was quite a different, and more difficult problem to show that third persons had misused inside information, than to establish the same fact as to beneficial owners or representatives. Therefore, retaining the "intention" standard as to beneficial owners and representatives, contained in both the House and Senate Bills, the Congress eliminated provisions, touching the use of inside information *by third persons,* altogether. The Circuit Court failed to grasp this fact altogether, when it remarked:

> "Anomalously the construction of the statute which defendants would have us adopt would impose an equally severe burden as to profits made by the insiders themselves" (R., pp. 134-135).

But the Congress thought that the distinction between insiders, and third persons, was of practical importance; that to demonstrate the use of inside information by an insider was relatively simple—by a third person, next to impossible. It was not for the Circuit Court to revise the judgment of the Congress! Indeed, the Circuit Court confused the proposed provisions in the Senate and House drafts, and the same provisions in the statute as enacted, relating to "*intention*" of "holding" the stock (**[**S4**]** **[**H2**]** and **[**3**]**) with the provisions in the Senate draft **[**S9-13**]** never carried forward to the enacted statute, relating to the use of inside information by third persons (opinion pp. 132-133).

Furthermore, in the nature of things, it is one thing to create a "rule of thumb" as to intention "of holding the security purchased or of not repurchasing the security sold" for more than six months—which is incapable of proof by any objective evidence—and another thing to create such a "rule of thumb" as to whether inside information was, in fact used by insiders—which is easily capable of objective proof. For, whether there was "inside information," is surely capable of demonstration. It is undisputed, in this case, that there was none, and that in any event, none was used. Whether such information was generally known, or known only to the beneficial owner, should not be any great mystery. Whether the director or officer or ten percent stockholder bought or sold stock is, certainly, also capable of demonstration from reports which are required to be filed with the Securities Exchange Commission, under pain of severe penalties for omission to do so (15 U. S. C. A., §§ 78p(a); 78t(c); 78u, 78 ff.). ***That was why such reports were required to be filed.*** And, accordingly, the activities of the representative or beneficial owner, in purchasing stock, with knowledge of such demonstrated facts,—while others, who did not have such knowledge, did not engage in such activities—usually permits of only one con-

clusion as to whether inside information was used. *Certainly the burden of explanation would be on the representative or beneficial owner!* A status quite different from that of third persons! Thus, in the presence of such available standards, reputations should not be blasted, and integrity questioned by any "rule of thumb"—to say nothing of a "rule of thumb" never intended to operate! In the absence of explicit expression of such a precise purpose, no inference of such an intention should be foisted on the Congress. And in the presence of such unequivocal legislative history, the deliberate judgment of the Congress should not be disparaged as "anomalous"!

The intended sanctions of the statute are thus found in its integrated definition of purpose and scope, as limited by and contained in the enactment and decretal clauses. Even were they inconsistent,

> "* * * express provisions in the body of an Act cannot be controlled or restrained by the title or preamble, * * *". (*Coosaw Mining Co.* v. *State of South Carolina,* 144 U. S. 550, 563.)

But as we have seen, they are not inconsistent, but complementary.

> "In our judgment the language used is so plain and unambiguous that a refusal to recognize its natural, obvious meaning would be justly regarded as indicating a purpose to change the law by judicial action based upon some supposed policy of Congress. But, as declared in *Hadden* v. *Barney,* 72 U. S. 5 Wall. 107, 111 * * * 'what is termed the policy of the government with reference to any particular legislation is generally a very uncertain thing, upon which all sorts of opinions, each variant from the other, may be formed by different persons. It is a ground much too unstable upon which to rest the judgment of the court in the interpretation of statutes.' 'Where the language of the Act is explicit,' this court has said, 'there is great danger in departing from the words used, to give an effect to the law which may be supposed to have been designed by the legislature. * * * It is not for the court to say, where the language of the statute is clear, that it shall be so construed as to embrace cases, because no good reason can be assigned why they were excluded from its

> provisions.' *Denn* v. *Reid,* 35 U. S. 10 Pet. 524, 527. * * * This court, speaking by Chief Justice Marshall, in *United States* v. *Fisher,* 6 U. S. 2 Cranch, 358, 385 * * * said that where the meaning of the legislature was plain 'it must be obeyed.'" (*Bate Refrigerating Co.* v. *Sultzberger,* 157 U. S. 1, 37-38.)

Here, there is not a mere preamble but an integrated definition of scope and purpose inseparable from the decretal provisions of the statute as a whole introducing a decretal provision so limited and so explicit as not to permit of judicial expansion. For it must be remembered that the purpose stated was not to interdict any use of inside information, but only to define under what circumstances such use was to be deemed "unfair."

People v. *Mancuso* (255 N. Y. 463), is, on this point, persuasive and analogous:

In that case, the defendants, who were directors of a bank, were indicted for participating in a fraudulent insolvency, in violation of Subdivision 1 of § 297 of the New York Penal Law. There was a demurrer to the indictment, presenting the question as to the proper construction of that penal statute. The statute provided that:

> "The insolvency of a moneyed corporation is deemed fraudulent unless its affairs appear upon investigation to have been administered fairly, legally and with the same care and diligence that agents receiving a compensation for their services are bound, by law, to observe."

It was argued that the statute created a standard "too vague to give warning to directors of the rule to be obeyed" (p. 469). But the court held (Chief Judge Cardozo writing the opinion) that:

> "To the extent that it establishes a presumption in favor of the People, it is arbitrary and void (*Manley* v. *Georgia, supra*). ***To the extent that it establishes a definition of a fraudulent insolvency, it is valid,*** * * *" (p. 469);

furthermore:

> "* * * that the definition of fraud implicit in the statute may be severed from any presumption whereby fraud must be repelled. Whether there

was in truth a purpose to establish such a presumption is at least not free from doubt. * * * Much may be said in support of the contention that what was re-enacted in the new statute was meant to be a definition and no more. Where two meanings are reasonable, the preference is given to the one that sustains a statute rather than to the one that overturns it. * * * This being the definition, the only consequence of eliminating the element of good faith or even the element of compliance with the law is not to increase the defendant's burden but rather to reduce it * * *'' (pp. 472, 474).

''Proof there must be of a causal connection between the wrong and the collapse before negligence will charge with a penal liability.

''In brief, the insolvency of a moneyed corporation resulting from the failure to administer its affairs with reasonable care and diligence is a fraudulent insolvency within the definition of the statute, and a director participates in the fraud when he participates in the negligence with ruin as the consequence * * *'' (p. 475).

Judge LEHMAN, concurring in the result, stated:

''A definition it certainly is, even though it may include a presumption. It gives a content to the words 'fraudulent insolvency' which those words might not otherwise have. It marks the line which divides innocent insolvency from fraudulent insolvency'' (p. 476).

Passing on to the contention that the statute was more than a definition, but a presumption, Judge LEHMAN continued:

''In the Penal Law of New York, if the presumption, though arbitrary, is applied in full rigor, it would establish only the 'fraudulent insolvency;' the People must still prove that the defendant as such director has 'participated in such fraud.' * * * At most the Legislature has retained vestiges of an invalid presumption'' (p. 477).

In concluding Judge LEHMAN said:

''In my opinion the Legislature has not attempted to define what acts by a director shall constitute par-

> ticipation in a fraud and it need not do so. The fraud is sufficiently defined" (p. 481).
>
> * * * * * * * * *
>
> "So construed the statute does not impose criminal responsibility upon a director merely because he has failed in care and prudence. There must be more before there is 'participation' in fraud. There must be an act or omission which logically leads to the inference that a director has had a share in the wrongful acts of corporate agents which rendered its insolvency fraudulent" (p. 482).

We submit that the principles of construction applied in the said case of *People* v. *Mancuso* (*supra*), are those which are applicable to § 16-b of the Securities Exchange Act. Indeed, unless the statute be interpreted to contain a definition of what constitutes the ***unfair*** use of inside information—as we suggest, i. e., only in connection with a "short swing"—it is illegal and invalid, upon grounds similar to those expressed by Judge KELLOGG, in the *Mancuso* case, when he was unable to agree with the majority of the court upon their construction of the statute.

In this connection, attention is drawn, in the opinion of the Circuit Court of Appeals (R., p. 133) to the opening phrase of § 16-b, which refers to "information which may have been obtained by such beneficial owner," etc., and the inference made, from this phrase, that what the Congress intended to prohibit was not the actual use of inside information, but the possibility that inside information might be used. But this argument ignores the history of the Senate Bill to which we have referred, and the fact that the phrase "may have been," is given full meaning if it is referred to the subsequent phrase **[3]** (*supra*, p. 10): "irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months."

Bearing in mind that the statute does not purport to do any more than define what is unfair, i. e., the use of inside information *on a "short swing"*—and no more—and that, in so defining "unfair," it decreed only that it should be immaterial whatever may have been the intention of the

beneficial owner as to holding the stock for a period longer than six months, it is a far cry to argue that the Congress was unconcerned with whether there was an actual abuse of inside information, and thus to disregard the decretal provision interdicting only any evidence that the beneficial owner did not intend to execute a *"short swing,"* i. e., within six months.

The fact is that the statute excludes from inquiry only one thing, i. e., what was the intention of the director or officer in acquiring or disposing of stock, as to the period for which he would hold it or refrain from reacquiring it. It does not exclude any proof which he may offer to show that he did not use any information obtained "by reason of his relationship to the issuer" or, as in the case at bar, that there was no such information at all.

Such a construction avoids an absurd or harsh result, "plainly at variance with the policy of the legislation as a whole," and is in harmony with the "purpose," as well as consistent with its literal decretal words (*U. S.* v. *American Trucking Assn.*, 310 U. S. 534, 543).

Such a construction would be justified under the familiar maxim *"expressio unius est exclusio alterius,"* as illustrated by *Continental Casualty Co.* v. *United States* (314 U. S. 527) in which this court concluded:

> "Generally speaking a 'legislative affirmative description' implies denial of the non-described powers" (p. 533).

Cases such as this, proceed upon the principle that the statement of an "affirmative" implies "a negative" as to all matters "not comprehended" within the statute (*Durousseau* v. *United States,* 6 Cranch 307, 314). So, the definition in the integrated purpose clause, that the use of inside information (in connection with a short swing) is *ipso facto* unfair, and the formulation of the single standard, in the enactment clause, that it shall be immaterial whatever may have been the intention of the fiduciary as to holding the stock or refraining from acquiring equivalent stock "enforces the affirmative inference that that which is omitted must be intended to have opposite and

contrary treatment'' (*Ford* v. *United States,* 273 U. S. 593, 611).

For, to add to the single standard formulated by the Congress, is to legislate. If the statement of purpose is broader than the decretal clause itself, then it is the decretal clause which should govern.

If, as stated by the learned courts below, the integrated purpose stated in the statute may be disregarded as a mere ''preamble,'' then certainly the decretal clause itself may not similarly be disregarded and ***the very definition of what is "unfair," i. e., to use inside information on a "short swing" and the decretal clause, too, taken out of the statute, altogether***!

The interpretation, for which we contend, would also be justified under the familiar principle that, in the construction of a statute, the courts should have in mind the spirit of the enactment and the purpose of the Congress, which—in this instance—was unquestionably solely to prevent the ''unfair'' practice of using inside information *on a short swing.*

Such an interpretation is also required in view of the serious and grave constitutional questions which otherwise arise (*infra,* pp. 55-65). To declare an Act of Congress unconstitutional is ''the gravest and most delicate duty'' (*U. S.* v. *Del. & Hudson Co.,* 213 U. S. 366, 407-408). It has been held that to avoid that necessity, or even to avoid the raising of grave doubts as to the statute's validity, it is the sense, rather than the literal words which should govern, even to the point of ''a strained construction.'' (*Blodgett* v. *Holden,* 275 U. S. 142, 148.) *A fortiori,* when regard for the literal words will make ''strained construction'' unnecessary, and eliminate constitutional questions altogether!

Finally, such an interpretation is required, to avoid harsh, unjust and absurd results, which could not have been intended by the Congress, and which the legislative record shows were not intended.

As applied to the facts—which are undisputed—in the case at bar, the application of these fundamental principles of construction is emphasized in a rather startling manner:

For the Circuit Court states that the statute should be construed to exclude any inquiry as to what actually occurred, solely because temptations are supposedly so prevalent (R., p. 142). But the record, in this case, shows that temptations, if there were any, were resisted. In fact, temptation is something which is an incident of human nature in whatever phases its fallibilities are demonstrated. Statutes should not be construed, nor decisions made, on assumptions as to the "frailities of human nature" nor on "general views of human nature but on the particular facts established in each case * * *" (*Blaustein* v. *Pan American Pt. T. Co.*, 263 App. Div. [N. Y.] 97, 122). Property cannot be taken arbitrarily, nor penalties inflicted, simply because temptations may be present—certainly not, when the evidence shows that they were inoperative. It would take the plainest of language—assuming the validity of such legislation—to compel a construction of such a character.

That the Circuit Court of Appeals, though bound to yield to the stipulated fact that defendants did not use inside information and acted in utmost good faith, nevertheless was influenced in its decision by an assumption precisely to the contrary, appears from a comparison of its statement that the defendants acted "in conceded good faith and without any 'unfair' use of inside information" (R., p. 129), with the later statement—quite without justification, in view of said stipulation—that, "It is naive to suppose that their knowledge of their own plans as officers did not give them most valuable inside knowledge as to what would probably happen to the stock in which they were dealing. It is difficult to find this use 'unfair' in the sense of illegal. It is certainly an advantage and a temptation within the general scope of the legislature's intended prohibition" (R., p. 135). *But the expressed purpose of the statute was not to prevent "temptation." On the contrary, it was to prevent the "unfair use" of inside information.* And the fact remains that the stipulated record is that there was not any "unfair" use of inside information, and that the negotiations which were closed "had no connection whatsoever

with the said prior negotiations, and were without prior suggestion by Delendo or Schenley, or any of the defendants, or any officers or directors of Delendo or Schenley" (fol. 131). Furthermore, in any event, action by the stockholders (whom defendants did not control) was necessary to approve of the sale of the Corporation's assets (fol. 132).

The truth may be "stranger than fiction," but this happens to be the truth—as certified by all parties to the litigation—a truth, which the court should not have disregarded.

The Circuit Court of Appeals considered that the statute inflicted a "penalty" (R., pp. 1508, 1511). True! And in such case the law is settled that, where a statute deprives an individual of property rights, or imposes a penalty or a liability, the construction of the statute must be strict, and no inferences of any kind indulged, to accomplish a deprivation of property: *Ransom* v. *Williams* (69 U. S. 313); *Shaw* v. *Merchant's Nat. Bank* (101 U. S. 557); *Lincoln Nat. Life Ins. Co.* v. *Hammer* (41 Fed. 2nd 12; C. C. A. 8th); *Matter of Water Commissioners of Amsterdam* (96 N. Y. 351, 357).

When we supplement these considerations by the further observation that the statute, as construed by the Circuit Court, forecloses the defendants from showing what is the truth, deprives them of an opportunity to be heard, and then penalizes them, by taking their property on assumptions which are belied by the record, we have a combination of all the elements, any one of which would be enough to give pause, lest the statute be deemed invalid (*infra,* pp. 55-65).

Not the least of the rights of an individual, under our Constitution, is to be free from the accusation of moral obliquity or violation of ethical concepts. At least, he has the right ***to be heard*** on the subject, before he is condemned. These rights, too, the statute takes away, if it be construed as the Government contends. *Walker* v. *McLoud* (204 U. S. 302, 309).

All of these grave consequences are eliminated, if the statute—in accordance with its express phraseology—be interpreted to ban a "short swing" as "unfair," only if

accompanied by the use of inside information, and to set up the rule that it is only whatever may have been the corporate representative's or beneficial owner's intention of holding the stock or refraining from purchasing it, in the six-months period, which shall be immaterial. So the statute reads!

The learned Circuit Court of Appeals misapprehended our contentions, in this respect:

We did not contend, nor do we now contend, that the so-called definition of purpose, with which § 16(b) opens was in itself "the controlling grant and limitation of authority of the entire section" (R., p. 131). On the contrary, it was our contention, and remains such, that the statement of purpose, coupled with the phraseology of the *enactment portions of the statute,* showed that what the Congress intended was only—if inside information was used—to rule out inquiry as to any intention of holding the stock for a period of six months. This, because of the view of the Congress that inquiry into so subjective a thing as the "intention" of the representative or beneficial owner, was impracticable—there being not even a suggestion that inquiry as to whether inside information was used, was similarly so to be regarded *as to corporate representatives,* as distinguished from third persons. The Circuit Court gave effect only to the statement of purpose—and then erroneously—because it exscinded the word "unfair." We contend that the decretal provision must be given effect too! Furthermore, that even were it to be deemed that there is inconsistency between them, the decretal provision must govern. General purposes are not always fully implemented; nor is the implementation always apt or efficient. That is why amendments of statutes are often necessary. It is not the judicial function to sit in revision of the Congress's judgment of expediency or to exercise its amendatory prerogatives.

The Circuit Court's entire discussion, on this point, involves unfortunate misapprehensions. There is nothing "subjective" about an inquiry as to whether inside information was used by insiders. Whether or not inside infor-

mation was used, is, on the contrary, objective, and capable of demonstration by circumstantial evidence. In the case of corporate representatives, it is aided by evidentiary presumptions, placing on them the onus of explanation. What is "subjective" is inquiry as to the intentions of the representatives or beneficial owner, with respect to holding the stock. The very quotation made by the Circuit Court, from Mr. Corcoran's testimony, shows its unfortunate confusion of these concepts (R., pp. 132-133). For Mr. Corcoran was referring only to "any intention or expectation to sell the security within six months." Yet, the court proceeds, in the very next paragraph, to discuss, not "intention" of holding stock, but use of inside information, i. e., "a subjective standard of proof, requiring a showing of an actual unfair use of inside information." Upon this misapprehension, the court proceeds to say that the use of such "a subjective standard of proof * * * would render senseless the provisions of the legislation." "Senseless," only because the learned Court misreads the statute, and disregards its history and decretal provisions. Again predicated upon the same misapprehension, the court proceeds to say that our construction, if adopted, would "torture the conditional 'may' in the preamble into a conclusive 'shall have' or 'has.'" But this ignores the fact that the so-called "preamble" [1] must be related to what alone is ruled out of consideration, i. e., "intention" [3]. So read, "may" remains "may," and the possibility that inside information may have been "unfairly" used is not given the effect of a conclusive rule of law that it was. The court overlooks that what is prohibited by the statute is not the use of inside information, *simpliciter,* but the use of inside information accompanied by a short swing, i. e., within six months. And the actual use of such inside information accompanied by a short swing carries with it the conclusive presumption that such short swing was intended. Thus, the adoption of our construction would not be to "ascribe to it [the statute] a meaning * * * inconsistent with its declared purpose" (R., p. 138), but, on the contrary, to declare the statute to mean what it says,

and to give effect to its history, and to its decretal provisions, which the Circuit Court exscinded from the statute altogether.

Furthermore, the statement made by the court, that our construction "would impose a more stringent statute of limitation upon the party aggrieved at the same time that it allowed the wrongdoer to share in the spoils of recovery" (R., p. 133), is not correct. Nothing in the statute abolishes common law actions for abuse of fiduciary obligation; and, accordingly, the statute of limitations with respect to such actions would remain exactly as it always was. What the Congressional enactment under discussion accomplishes, is that, irrespective of actual "intention" as to "holding" the stock, liability results from the mere use of inside information in connection with short swings, i. e., within six months. This is a new cause of action—in favor of the corporation—and governed by a new statute of limitations, utterly unrelated to any existing statutes of limitation, which affect remedies heretofore existing and which are concurrently enforcible with the new remedy made available by the statute.

The effect of the statute, as we view it, is merely this: If inside information was used, accompanied by a short swing, i. e., within six months, then there need be no inquiry as to what was the "intention" of the representative or beneficial owner as to "holding" the stock. The use of inside information accompanied by a short swing transaction, i. e., within six months, was to be deemed *ipso facto* unfair. The mere fact that inside information was used, where a sale followed purchase or a purchase followed sale, within the six-months period was to carry with it the conclusive presumption that such use was unfair, and that the user intended to operate on a short swing.

POINT II.

The statute contemplates that "profit realized" and inuring to the benefit of the corporation should be actual profit, with reference to the sale and purchase, or purchase and sale of the same stock, as contemplated by the Income Tax Law. The Circuit Court, in holding to the contrary, followed a proposal disapproved by the Congress, and disregarded the clear provisions of the statute as enacted.

This portion of the statute [2] reflects the plain intention of the Congress that "profit realized" should be estimated only upon matching actual phases of sale and purchase with respect to the same stock. In failing to give effect to the statutory mandate, the District Judge as we shall show, completely overlooked, and the Circuit Court of Appeals disregarded, the fact that the interpretation adopted by them was one of two recommendations, both of which had been explicitly rejected by the Congress.

The phraseology of the statute is clearly to the effect that it is the "profit realized" in the acquisition and disposition phases of the same transaction which are contemplated, because the reference is not to ***any*** purchase or ***any*** sale considered as a part of a running account "extending over a period of less than six months" and calculated "irrespective of the certificates" (as in the Senate draft [S6] [S7] [S12] [S13]), but to "the purchase ***and*** sale" and, again to "the sale ***and*** purchase," ***"of the security involved"*** [2] each time, in consolidated phrases, within commas, pointing clearly to a unit transaction from either aspect—sale or purchase.

Furthermore, from the fact that all reference to certificates was omitted from the statute as enacted, it is clear that Congress repudiated Mr. Corcoran's proposal (as reflected in both the varying Senate [S7] [S13] and House drafts [H3]) which, in the Senate draft, contemplated that the penalty would be measured by "***any*** profit made * * * on ***any*** transaction in such a registered security extending over a period of less than six months" [S3] at the "high-

est" price for sales and "lowest" price for purchases ([S6] and [S12]) in the six months period, and in the House draft, that the penalty would be measured by the difference between the "aggregate" purchases and "aggregate" sales [H3]—each quite different from the provisions of the present statute, making each dealing an independent transaction, separate from all others, and requiring the "profit realized" to be computed on the comparison of the sales and purchase phases of the very same stock involved.

There really can be no doubt of the intention of the Congress. For the statute as enacted, to make assurance doubly sure, adds the word "realized" [2]—taken from the House Bill [H1] to the word "profit" as proposed in the Senate draft [S6]! Furthermore, instead of stipulating merely that an action under the statute, as to any six months period, might be brought at any time within sixty days after request had failed to produce corporate action [S5] [S11], Congress provided that in any event "no such suit shall be brought more than two years after the date such profit was *realized*" [4]—a standard capable of practical administration, if the inquiry was as to complementary phases of purchase and sale of the same stock, but utterly unworkable, if either the "lowest vs. highest" formula of the Senate Bill, or the "aggregate" formula of the House Bill, had been retained. For under either the rejected Senate or House drafts, the two year limitation would have been practical—if at all—only if it ran from the end of the six months period for which profit was arbitrarily computed by either the "lowest vs. highest" or "aggregate" formula.

Significantly, this word "realized," appearing in the statute as enacted and taken from the House Bill [H1] after the discussions concerning the income tax law (*infra*, p. 38) —is a word of art, currently used in income tax procedure, and existing in income tax regulations at the very time that the statute was enacted, on October 1, 1934 (cf. Treasury Department Regulations 77 [1932], employing the terms "realized" and "realization"—as to computation of net income [Article 58, pp. 15-16; Article 321, p. 105; Article 551-

561, pp. 162-163]—and Treasury Department Regulations 103 [1940—§19.22, p. 34; §19.41-1, pp. 186-187; § 19.107-1—§ 19.111-1, p. 253]; see also, *Eisner* v. *Macomber, infra,* (p. 46).

The Courts below, incomprehensibly, failed to recognize this unmistakable index to Congressional intention. *Surely, the presence of the word "realized," in the statute as enacted, permits of no possible inference that the fictitious "lowest vs. highest" "profit" formula of the Senate draft was intended to be enforced!* And *surely no possible justification appears—once the phraseology of the Congressional enactment was disregarded—for judicial adoption of the Senate "lowest vs. highest" formula rather than the House "aggregate" version which did contain the phrase "profit realized"* [H1]!

Again, in this respect, the comments made by Mr. Corcoran, in the hearings before the Legislative Committee, must be carefully read and appraised, lest his personal opinions with respect to a different proposal, repudiated by the Congress, be taken as interpretation of the present enactment.

So, in discussing the phraseology of the draft statute—the following colloquy took place:

> "Senator Barkley. Suppose a man buys 100 shares at $10, and 100 shares at $12, and 100 shares at $15. The lowest price, of course, is 10. Suppose he sells it for 20, 22 and 25. The highest price is 25. As I understand this language, the profit on the total amount of stock is the difference between 10 and 25.
>
> Mr. Corcoran. Oh, no. He buys 10 shares at three different prices. If he sold 10 shares, the profit would be the biggest spread between the lowest price at which he bought 10 shares and the highest price at which he sold 10 shares. But if he sold 30 shares, you would take, for the first 10 shares, the biggest spread of profit, for the next 10 shares the next biggest spread of profit, and for the third 10 shares, the next biggest spread of profit. But you would not establish a given spread of profit for all three sales on the widest spread between the lowest price and the highest sale.

> Senator Barkley. ***All these transactions are a matter of record.*** It seems to me the simple way would be to charge him with the ***actual profit***" (Hearings before the Senate Committee, pp. 6558-6559).

After this plain indication that at least Senator Barkley thought that the ***actual profit*** should be computed, as to each transaction, we have the following significant exchange of views, which makes it quite clear that the standard preferred was that fixed by the income tax law:

> "Mr. Corcoran. * * *
> ***It is the same provision you have in the income-tax law. Unless you can prove the actual relationship between certificates,*** you take the highest price sold and the lowest price bought" (Hearing before Senate Committee, p. 6559).

As the Circuit Court of Appeals appreciated (R., p. 137) Mr. Corcoran's views as to some of the phases of the income tax law were quite erroneous, for he overlooked the "First In First Out Rule." But his remark, nevertheless, retains its significance (which the Circuit Court of Appeals completely misapprehended), for it reflects a purpose to conform to the conceptions of "profit realized" formulated by the income tax law, and confirmed that when "you can prove the actual relationship between certificates," it is the "profit realized" on those very certificates, which is to be computed. It must be presumed, therefore, that the Senate rejected Mr. Corcoran's proposed formula for measuring "profit",—which was inconsistent with income tax procedure—and therefore eliminated [S6] [S7] [S12] and [S13], and instead provided that "profit realized" be measured, in accord with the income tax law. *This would seem to be conclusive evidence that the Congress fully appreciated Mr. Corcoran's lack of knowledge of the income tax procedure, refused to follow his misconceptions, and instead adopted the income tax standard.*

Nevertheless, the Circuit Court, curiously enough, thought it more important to ascertain "the rule the proponents had in mind, though its source is erroneously stated" (R., pp. 137-138). To us it seems that the issue

is, not what the "proponents" desired, but what Congress did.

In any event, that Mr. Corcoran was wrong in his view of what were some of the income tax rules, is beside the point. What is material is that the Congress—as indicated by the expression of Mr. Corcoran's views and those of the Senators participating in the hearings—intended to adopt the income tax rules, whatever they might be. To brush aside these income tax rules, as mere rules of "convenience"—as suggested by the Circuit Court (R., p. 138)— does not meet the issue. Whether they be deemed mere rules of convenience, or what not, the fact remains that they were generally accepted, known to the Congress, and unquestionably in its contemplation. Furthermore it is clear that the Congress intended that the same rules which were made applicable under the income tax law, should govern the definition of profits under the Securities and Exchange Act.

> "But even if the statute be not so explicit as to preclude construction; if upon applying to it the established rules of interpretation; if looking at it in the light of previous legislation on the subject; if there be reasonable ground for adopting either one of two constructions; this court, without departing from sound principle, may well adopt that construction which is in harmony with the settled practice of the executive branch of the government, and with the course of judicial decisions in the circuit courts of the United States; especially if there be reason to suppose that vast interests may have grown up under that practice and under judicial decisions which may be disturbed or destroyed by the announcement of a different rule." (*Bate Refrigerating Co.* v. *Sulzberger,* 157 U. S. 1, 37-38.)
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> * * * * * * * * *

We see no escape from the application of those principles to the case at bar, particularly in view of the fact that the very formula for measuring "profit," which has thus far been sustained by the courts below, was submitted to the Congress in the draft statutes, and eliminated from the final statute. Indeed, we are unable to follow the reasoning of the Circuit Court, when it states, "Actually the Act

as passed is a combination of H. R. 9323 and S. 3420 * * *. And its failure to specify a method of computation may well be thought more of a sanction of the formula devised in S. 2693 than an expression of hostility towards it" (R., p. 136). But by what judicial inspiration may it be said that the Congress preferred the Senate "lowest vs. highest" formula to the House "aggregate" formula? We must remember that there was not one recommended formula, but two, and that Congressional silence hardly evinces an election as between the two! Furthermore, in the respects now under consideration, the Congressional enactment is more of a combination of H. R. 8720 and S. 3420, than of H. R. 9323 and S. 3420. Indeed H. R. 9323 bears practically no resemblance to the statute as enacted. The fact is that the Congress did not make any combination of bills under consideration, but developed a new formula. It did not merely "fail" to specify a method of computation. It rejected both recommended methods, and substituted still another. The coupling accomplished, on the occasion of every reference, to the complementary phases of sale and purchase, with respect to the same stock transaction, cannot be overlooked, if, in this respect, the mandate of statutory construction—that every word in a statute must be given due meaning—is to be observed. (*Springer* v. *Philippine Islands* [277 U. S. 189].) If the statute, as enacted, represents a combination of the Senate and House bills, then, in the combination, that reflecting the view now adopted by the Circuit Court of Appeals disappeared altogether. For about the only thing they had in common was the thought that "profit" should be fictitiously computed, a concept which the Congress rejected, and the Circuit Court (exercising a preference for the Senate bill fiction) has now restored, notwithstanding Congressional rejection. Accordingly, if the Congress' failure to specify the method of computation recommended by the Senate bill is now to be construed as an adoption of that rejected formula—in view of the fact, that, in the bill which was rejected, the very computation which is now adopted by the court, was formulated in plain English—then, the legislative process is revealed to be a most extraordinary thing, contrary to

what one would expect to find in all other human experiences—to say nothing of settled canons of construction. This, to use the Circuit Court's phrase, is carrying "judicial fantasy" too far (R., p. 137). *It does not account for judicial acceptance of the Senate draft in preference to that of the House.*

Nor was the Circuit Court consistent in applying its views of the proper function of "judicial fantasy." For by the same standard, it might have concluded that when the statute as enacted [3] carried over from both the Senate bill [S4] and the House bill [H2] only the single exclusion as to "intention" of "holding" the stock, it intended to do no more than exclude that one consideration, so that whether inside information was actually used would have remained open for inquiry. Indeed "fantasy" was not required to reach that result. Plain logic required it. The statement of purpose incorporated in the statute as enacted, is given full effect if limited to "unfair" use of information, and utilized to justify exclusion only of any inquiry as to "intention" of "holding" the stock.

It is interesting to observe that the Circuit Court of Appeals seemed quite troubled about its extra-statutory method of computation. After searching for one formula after another, it seemed to think that it was for the defendants to suggest a proper formula (R., p. 141), when Congress had rejected the very formula which the court adopted. But, the statute is what Congress made it. The duty of the court was to apply it; not to look for another which it thought would work better. The meaning of the statute does not depend upon the lack of ingenuity which defendants' counsel display, to work out a formula which will make the Congressional enactment appear to mean what it clearly does not say, and which the Congress undoubtedly rejected as its possible meaning.

The utterly arbitrary character of the construction thus far given to the statute—showing that there is neither rhyme nor reason to the formula announced for computing "profits,"—is apparent from what, otherwise, might be deemed the insignificant correction made by the District Judge, in increasing the damages assessable against the

defendant Kaplan by the sum of $16.98 (fol. 251). It will be worthwhile to observe what occasioned this correction:

Following the formula of matching off lowest price acquisitions against highest price sales—utterly unsupported by anything in the statute, but indeed contradicted by it—the District Judge—when he got to the end of the trail, and matched off the lowest remaining purchase at $653.73, against the highest remaining sale, at $636.75 (opinion, fol. 248), found that, instead of there being a profit, there was a loss, as a result of bringing together these utterly unrelated transactions.

Accordingly, the District Judge, finding a loss, gave the defendant Kaplan the benefit of that loss (fol. 248). But this did not satisfy the Government. Even though it contended that it could assess, against the defendant Kaplan, an artificial profit, which was not a "profit realized," it certainly was not going to give him the benefit of an artificial loss, which was not a loss. Therefore, representations were made to the learned District Judge, by the government, that, in such a case, there should be a stand-off, and that, while there was no profit, neither should there be a loss; and the learned District Judge followed that recommendation, as indicated in his supplementary opinion (fol. 251). He did so, however,— and the Circuit Court reached the same conclusion by the same process—by exscinding the word "realized" from the statute (cf. R., p. 84, fols. 251 and 140). It is impossible for us to understand how one may ascertain a "realized" profit, without making due allowance for losses in the constituent transactions making up the aggregate of transactions on which such "profit realized" is calculated!

Such is a result which necessarily follows, once we abandon the command of the statute, and adopt artificial standards, having for their purpose to create a profit, whether there was one or not. Were the word "profit" taken in its ordinary meaning, as connoting a gain, the error committed by the learned District Judge, in his original findings, could not have been made, nor, for that matter, could the whole process, by which he estimated

damages, have been undertaken. For, surely, the same measure by which a profit is created, ought to be the measure by which a loss is ascertained. But, *mirabile dictu,* in the mathematics of the Commission, one determines a profit by different mathematical standards from those applicable to determining a loss! To ascertain profits, one matches up unrelated transactions, and, to ascertain losses, one does not even match them up! Everything depends on what is the answer desired. If the actual process results in a detriment to the defendant, then the process by which such detriment is ascertained, must be right. If it results in a benefit to the defendant, then a new process must be found. For what is important, is not the phraseology of the statute, nor the mathematical process by which damages are ascertained, but the result—and that must come out as detrimental to the defendants as possible!

Moreover, common sense and experience tells us that each certificate of stock does represent a separate, identifiable, traceable, and independent piece of property.

It is not an answer to this observation to say, as did the learned District Judge, that one share of stock is like another, that each represents an undivided interest in the surplus of the corporation—for which is cited *Richardson* v. *Shaw* (209 U. S. 365 [fol. 225]). For that was a case in which the court had under consideration the question as to what was a broker's obligation in returning stock to a customer, equivalent to that which the customer had given the broker as collateral security. Obviously, in such a situation, it cannot make the slightest difference what certificates of stock are given to the broker, or what certificates of stock the broker returns to the customer. Under such circumstances, there are no property consequences attaching to the identity of the certificates.

But, in the case at bar, there are property consequences. The tax which a taxpayer pays, depends upon identification of the particular stock which is the subject of purchase and the subject of sale. His use of his property, and the benefits which he can obtain from it, and the depri-

vations which, under the Securities Exchange Act, it is attempted to impose upon him, depend upon an identification of the stock. And this is not merely a matter of certificate numbers, but of substance.

Nor is it true that, for all purposes, one share of stock is like another—even generally speaking. The law which is applicable to property rights, their incidence, and their transfer, is the State law, and not the federal law (*Erie R. Co.* v. *Tompkins,* 304 U. S. 64). Under the law of New York, where the transactions occurred, a certificate of stock is a property interest, separate and distinct from the undivided share of the corporate surplus which it represents. It may be subject to attachment (N. Y. Personal Property Law, § 174); it may be stolen (N. Y. Penal Law, sec. 1290; *In re Jones,* 172 N. Y. 575; *Simpson* v. *Jersey City Contracting Co.,* 165 N. Y. 193); it may be bought and sold; it may be pledged; it has characteristics of negotiability; a thief may give a better title than that of the true owner (*N. Y. Pers. Prop. Law,* secs. 166, 167); it passes from hand to hand, as an incident of commerce, as property in a very real sense. This is so, even for purposes of exercising the voting rights, which are an essential part of the property interest involved, in the affairs of the corporation (Stock Corporation Law of New York, § 65). The very Security Exchange Acts, themselves, proceed on the assumption that stock certificates are commodities, in interstate commerce, apart from the intangible interests they represent (Hearings before Senate Committee).

What better demonstration could there be of the substantial property interest reflected in a specific stock transaction, as evidenced by the certificates of stock, integrating it—completely exploding the learned District Court's assertion that *identifiable* stock certificates are "fungible" (fol. 225), like *unidentifiable* grains of wheat—than the very argument made by the Government in the courts below that stock purchases, held for two years, are considered, for tax purposes, an investment, while those held for a shorter period are considered of speculative nature (citing *Davis*

v. *United States,* 87 Fed. [2d] 323)! How is the taxpayer to obtain the benefit of that rule, if, in the computation of gain, the fact that he made a ***specific*** purchase, the subject matter of which he did not sell for more than two years, is to be disregarded! And if the taxpayer may so specifically identify his transaction, for tax purposes, will that very same transaction be deemed to show a profit, when called in question under subdivision (b) of Section 16 although for tax purposes there was no profit—which is the very situation presented in the case at bar? How absurd and unjust is such a conclusion! A more outrageous forfeiture can hardly be imagined!

The phrase "profit realized" means exactly what its words say. It is a settled rule of construction that words must be taken in their ordinary and commonly-accepted sense (*Caminetti* v. *United States,* 242 U. S. 470; *Cooper-Snell* v. *New York,* 230 N. Y. 249). "Profit"—to say nothing of "profit *realized*" is "the difference between cost and yield," the "gain made upon any business or investment when both the receipts and payments are taken into account" (*Providence Rubber Co.* v. *Goodyear,* 9 Wall. 788). "It makes the wrongdoer liable for ***actual,*** not possible gains" (idem. p. 804). There can be no "profits," unless one first ascertains the cost, then the proceeds of sale, and, then, determines the difference between the two.

We think the reasoning of *Eisner* v. *Macomber* (252 U. S. 189), is very much in point: In answer to the contention there made, that stock dividends should be taxed because "a stockholder may sell the new shares acquired in the stock dividend," the court said:

> "It is equally true that if he does sell, and in doing so realizes a profit, such profit, like any other, is income * * *. The same would be true were he to sell some of his *original* shares at a profit" (p. 212)—

a very clear differentiation between the property interest contained in one set of shares, as distinguished from another—justifying the conclusion of this court, in the *Eisner* case, that it should not "disregard the essential truth disclosed * * * and indulge the fiction that they have re-

ceived and *realized* a share of the profits of the company which in truth they have neither received nor *realized*" (p. 214).

Note, as in the statute under discussion, the word "realized"!

Furthermore, the Securities and Exchange Commission itself, in recognition of the interpretation which we give to the statute, adopted Rule X-16B-1, of its General Rules—which distinctly recognizes the identifiability of stock transactions (quoted, *infra*, p. 52). For, otherwise, what sense would there be to a rule which exempted, from the provisions of the statute, a purchase of stock which was made prior to the enactment of the statute, followed by a sale made within six months, while the statute was effective? *If it made no difference whatsoever, as to what stock was bought and what stock was sold, why such a rule, and what sense is there to it?*

Nor is it true as suggested in the opinion of the Circuit Court of Appeals, that a statute contemplating only the recapture of actual profits from the purchase and sale, or sale and purchase, of identical certificates would be "substantially emasculated" and that the "income tax rules cannot apply without defeating the law almost completely" (R., p. 138). Assuming, without conceding, that it is immaterial whether defendants actually used inside information, the fact remains that 1700 shares both purchased and sold within the six-months period, are literally within our conception of the "profit realized" definition of the statute. That a statute may be "circumvented" is beside the point. All statutes may be. So, in the tax field, there is a recognized distinction between "evasion" and "avoidance." *Bullen* v. *Wisconsin*, 240 U. S. 625, 630, 631; *Superior Oil Co.* v. *Mississippi*, 280 U. S. 390, 395, 396, *Gregory* v. *Helvering* (293 U. S. 465, 469). Furthermore, the thought expressed that the beneficial owner might always draw from his "reservoir" or "backlog" (R., p. 139) of stock is without substance. For there can be no presumption that the "reservoir" stock would always have been acquired at prices sufficient to defeat a "profit realized." Further-

more, it is not correct to say, as did the Circuit Court that, under our construction, "a purchase followed immediately by a sale * * * would often be held immune from the statutory penalty because the purchase would be deemed by arbitrary rule to have been made at an earlier date; while a sale followed by purchase would never even be within the terms of the ~~sale~~ rule" (R., p. 139). The correlation would never be "arbitrary," but in accord with rules as to identifiability established by income tax precedure, which respects the intention of the parties, but puts the burden of proof on the taxpayer. Nor, for the same reason is it true that "a sale followed by a purchase would never even be within the terms of the ~~sale~~ rule." (See for a correct statement of the rule, the court's footnote 15 at R., p. 137, and the authorities cited in footnote 18, at R., p. 138.) Moreover, Congress did not rule out the thought of any profit at all, but appropriated only such profit as was made on complementary transactions on a "short swing," i. e., within six months. To recognize that explicitly stated intention is not to "ascribe" to the enactment "a meaning so inconsistent with its declared purpose" (R., p. 138) but to effectuate that purpose. In any event, it is not for the courts to substitute their judgment of expediency for that of the Congress. If Congress limited liability to complementary phases of the same transaction *within six months* —and about this there can be no doubt—then surely it did not intend to defeat that limitation by making it immaterial whether the consummating phase was indeed *complementary* to the initial phase. If it had intended such a result, there appears no conceivable reason whatsoever for its rejection of the precisely apt language contained in the Senate and House drafts. For the Circuit Court to conclude, as it did, that because the Congress rejected the peculiarly apt, though different, phrasings of the Senate and House Bills, it thereby intended to incorporate the effect of one of them, i. e., that of the Senate Bill, passes our understanding!

As was said in *U. S.* v. *Gilliland* (312 U. S. 86), with respect to an amendment of this character—following a similar legislative history—"We see no reason why this

apparent intention should be frustrated by construction. * * * If the language of the amended section could be deemed ambiguous, the legislative history of the amendment would dispel any doubt as to the congressional purpose" (p. 93—cf. *Neuberger* v. *Commissioner,* 311 U. S. 83, 89-90).

If the Congress had intended to disregard actual "profit realized," and to brush aside differentiation between identifiable stock acquisitions which accord with "standard business practice" (cf. *Maass* v. *Higgins,* 312 U. S. 443, 448-449), it could have employed the precise phraseology to that effect, of one or the other of the draft bills both of which were rejected, instead of the present phraseology which is too plain for debate. It is not the function of the courts "to engraft on a statute additions which we think the legislature logically might or should have made" (*U. S.* v. *Cooper Corp.,* 312 U. S. 600, 605).

As said by this court:

> "To limit this statute in the manner now asked for would be to make a new law, not to enforce an old one. This is no part of our duty" (*United States* v. *Reese,* 92 U. S. 214, 221).

Paraphrasing what was said by this court in *Meyer* v. *Wells, Fargo & Co.* (23 U. S. 298, 300, 302): "It would be possible only by some extraordinary turn of ingenuity" to conclude that Congress would "sustain" this construction after "condemning" the recommendations made in draft bills. As was said by this court in said case:

> "But we see no possible construction on which it could be upheld without being so remodeled that it would be a mere speculation whether the legislature would have passed it in the new form. * * * Neither the court below nor this court can reshape the statute simply because it embraces elements that it might have reached if it had been drawn with a different measure and intent."

A fortiori, when the interpretation adopted by the Circuit Court was proffered to the Congress, in unmistakable phraseology, and rejected!

It is the judicial function to interpret the Congressional

enactment—not to substitute its own judgment of expediency by implementing a Congressional statement of purpose with one of two means, both of which the Congress rejected.

The issue, in every case, is not whether a statute **can** be circumvented, but whether it has been. And this depends (1) on what the statute says, and (2) on what has, in fact, been done. In the case at bar, the statute explicitly requires that the identity of the stock transaction be respected. There is no room for reasonable doubt as to its proper construction. The decretal clause as to "intention" is too plain for debate. So is the phraseology as to "profit realized." " * * * the language being plain, and not leading to absurd or wholly impracticable consequences, it is the sole evidence of the ultimate legislative intent" (*Caminetti* v. *United States,* 242 U. S. 470, 490). And the undisputed evidence shows that there was neither circumvention by the defendants, nor purpose to accomplish it, but on the contrary, unexceptionable conduct of unquestionable integrity.

Adopting a proper standard for the calculation of profit, so that it embraces only actual "profit realized," computed with respect to the same stock transactions, the fact is that Kaplan made a profit, of only $23.91 on one transaction:

On December 1, 1939, Kaplan acquired 500 shares, represented by certificates numbered 16782-16786, inclusive, at a cost of $775 (fol. 173). The shares represented by these very same certificates, were sold on April 19, 1940, for $750 (fol. 182), thus resulting in a loss of $25.

On February 5, 1940, Kaplan acquired 200 shares, represented by certificates numbered 14876 and 14894, at a cost of $285 (fol. 174). The shares represented by these certificates were sold on February 15, 1940, for $308.91 (fol. 181), thus resulting in a profit of $23.91.

On March 27, 1940, Kaplan acquired 1000 shares, represented by certificates numbered 10523, 10820, 11691, 12328, 12454, 12814, 13052, 13146, 14842 and 16100, at a

cost of $2,560 (fols. 178-179). The shares represented by these certificates were sold on May 7, 1940, for $2,525 (fol. 182), thus resulting in a loss of $35.

Accordingly, only on one transaction did Kaplan "realize" a profit, i. e., $23.91.

POINT III.

The statute does not have application to transactions, the purchase phases of which antedated the effective date of the statute.

This point is important, in connection with the asserted liability of both defendants, Seskis and Kaplan with respect to stock acquired by them ***prior to the effective date of the statute,*** i. e., prior to October 1, 1934 (Ex. 2, par. 20). The courts below construed the statute so as to make it immaterial whether said defendants when they sold stock within the six-months period in question, sold stock acquired prior to said date, i. e., October 1, 1934, or stock acquired subsequent to said date.

Subdivision (b) of § 16 of the Securities Exchange Act of 1934 became effective on October 1, 1934.

As to the power of the Congress to interfere with the use of property and vested rights, acquired prior to that date, we treat at a later point (*infra,* p. 57). At this point, we limit ourselves to a demonstration of the manifest intention of the Congress to exclude, from the scope of operation of the statute, any transactions resulting in the vesting of rights prior to the effective date of the statute.

There is nothing in the statute which indicates a purpose to create a retroactive effect. It is a settled canon of construction that such an effect will not be inferred, and that, in the absence of express language, the operation of the statute will be deemed prospective. *Lewellyn* v. *Frick* (268 U. S. 238); *Schwab* v. *Doyle* (258 U. S. 529).

Furthermore, the very "General Rules and Regulations under the Securities Exchange Act of 1934 as amended to and including February 15, 1941," contain conclusive evidence that the Commission itself construes the statute as

having no retroactive effect. So, Rule X-16B-1 of said "General Rules and Regulations," is as follows:

> ***"Exemption of Certain Transactions Originating Prior to October 1, 1934, from Section 16(b).***
>
> "A purchase which is effected before October 1, 1934, followed by a sale after October 1, 1934, within 6 months of such purchase, or a sale which is effected before October 1, 1934, followed by a purchase after October 1, 1934, within 6 months of such sale, shall be exempt from the provisions of section 16(b)" (p. 1604).

Accordingly, under this rule, a purchase made prior to October 1, 1934, though followed by a sale after October 1, 1934, within six months of such purchase, is exempted; and similarly with respect to a sale made before October 1, 1934, though followed by a purchase within six months of such sale. Of course, the fact that the rule refers to complementary phases of the same transaction "within six months," is of no consequence at all, for since the statute purports to refer solely to transactions within six months, the exemption purports to apply only to that which the statute purports to include, and is not, therefore, required to be any broader than the apparent inclusion accomplished by the statute. It would be absurd to argue that such complementary phases of the same transaction, if the last phase occurred within six months, under the circumstances mentioned in the rule, would be exempted, but, if the last phase occurred within six years—as in the case at bar—would not be. *All purchases made prior to the effective date of the statute are necessarily in the same category. Any attempt to favor some, and discriminate against others, is arbitrary and confiscatory. Defendants, who are affected by that discrimination, have a right to be heard to complain.*

Upon this point, the Circuit Court of Appeals seems also to have misapprehended the true effect of the criticisms urged by us:

So, in the footnote (23) at R., p. 142, the Circuit Court stated:

> "There might well be substantial objection to an application of the statute to transactions effected in

whole or in part prior to the Act, but the Commission has specifically exempted such activities by Rule X-16B-1 of its 'General Rules and Regulations,' 17 CFR 240.16b-1."

From this footnote, it is quite apparent that, if the Circuit Court's conception of the effect of this rule had been correct, it would have been bound to hold that the statute had no application to any and all shares of stock acquired before its enactment, and that there could be no discrimination against defendants. That the Circuit Court did misapprehend the rule, seems quite clear. For, by what standard may the Congressional enactment be deemed to apply to shares of stock acquired before the effective date of the statute, but sold within six months after that effective date, and yet not be deemed to apply to the very same shares of stock, similarly acquired before the effective date of the statute, but sold seven months or three years, or more, after the statute went into effect?

The Circuit Court overlooked the fact that the period of "six months" was stipulated in the Commission's rule, because such period measured the entire operating scope of the Congressional enactment. Accordingly, by the same standard, any transaction having its initial phase prior to the effective date of the enactment, and its concluding phase *at any time thereafter,* should be exempted also.

It is just this point which, thus far, we have not been able to impress upon the courts below, i. e., that the very formulation of such a rule—making such an arbitrary discrimination between transactions in which the consummating phase occurred within six months after the effective date of the statute, on the one hand, and transactions in which—as in the case at bar—the consummating phase occurred later than six months after the effective date of the statute, on the other hand—works serious illegal and unconstitutional prejudice to the defendants in this case. If it is a taking of property for the statute to be deemed to embrace stock sold or purchased within six months after the statute became effective—as the Circuit Court seems to concede—why is it not a taking of property if the sale

or purchase occurred within seven months? And if the Securities and Exchange Commission may draw the line at six months after the effective date of the enactment, though the Congress has made no such discrimination, then it seems just as clear that it is the Securities and Exchange Commission which is legislating, and to which the Congress has delegated that power.

The rule involved—contrary to the views expressed in the opinions below (R., fol. 242; Circuit Court opinion, R., pp. 143-144) does affect defendants. It discriminated against them! They have a right to be heard with respect to it!

POINT IV.

Seskis' delivery of 15,800 shares of stock, in payment of an antecedent indebtedness, was not a "sale," within the meaning of the statute. It should be measured by the same standard as that applicable to Kaplan's acquisition of the same shares.

We contend that Seskis's delivery to Kaplan of 15,800 shares of stock, in payment of an antecedent indebtedness, was not a "sale" within the meaning of the statute.

The sale contemplated by the statute was, undoubtedly, a sale for a price concurrently stipulated. The proceedings before the legislative committee show very clearly that the Congress intended to prevent "short swing" speculation, and nothing else. When an individual makes a gift of his stock, there is no sale. This was finally conceded by the plaintiffs and the Government in the District Court. When an individual who has made a purchase, dies, and his estate sells, that is not a sale. This was conceded by Mr. Corcoran, in the Senate hearings (p. 6558). Certainly, the last-mentioned instance—if the word "sale" is to be literally construed—is included within it. Apparently, a literal isolation of even the word "sale" was not intended. It was only the "short swing" against which the Congress was aiming.

By the same standard, transactions such as those of the defendants in this case, which were made in liquidation

of an existing indebtedness (fol. 170)—not for a concurrent price, but in accord and satisfaction of an obligation theretofore accrued—are not sales within the meaning of the statute (cf. discussion, 55 C. J., § 8, p. 42; *Matter of Franks*, 154 Misc. [N. Y.] 472).

There is a fundamental incongruity in holding that Kaplan's receipt of 15,800 shares from Seskis is not within the statute (fol. 368), but that Seskis' delivery of those very shares to Kaplan, is. The securities could not have been "acquired in good faith" [2] by Kaplan, unless delivered "in good faith" by Seskis. Under a statute such as this, the two sides of the same transaction should be measured by the same standard.

Furthermore, we contend that private transactions between two directors, are not within the meaning of the statute. *Certainly, nothing they did, privately as between themselves, could affect the market, or the flow of commerce.* As between directors, it is inconceivable that one could use inside information for a "short swing."

SECTION II.

(Treating of Validity of the Statute.)

POINT V.

The statute deprives the defendants of property, without due process of law, in violation of the Fifth Amendment to the Constitution of the United States.

(A)

THE CONGRESS MAY NOT CREATE A CONCLUSIVE PRESUMPTION WHICH RESULTS IN PENALIZING THE DEFENDANTS, WITHOUT OPPORTUNITY ON THEIR PART TO BE HEARD TO SHOW THAT, AT NO TIME AND IN NO MANNER, DID THEY VIOLATE ANY OF THEIR OBLIGATIONS TO THE CORPORATION OR ITS STOCKHOLDERS.

If our construction of the statute is not adopted, with the result that there may not be any inquiry as to whether inside information was actually used, then the statute

creates a conclusive presumption of wrongful conduct although it is undisputed that there was no wrongful conduct. Accordingly, the statute is invalid. For to brush aside mere motives or intentions as to an act actually committed, is one thing; to presume that an act was done, which was not done, quite another!

Heiner v. *Donnan* (285 U. S. 312) is in point. In that case, this court said, in part:

> "However, whether the latter presumption be treated *as a rule of evidence or substantive law,* it constitutes an attempt, by legislative flat, to enact into existence a fact which here does not, and cannot be made to exist in actuality, and the result is the same * * *. This court has held more than once that a statute creating a presumption which operates to deny a fair opportunity to rebut it violates the due process clause of the Fourteenth Amendment. * * *
>
> "If a legislative body is without power to enact as a rule of evidence a statute denying a litigant the right to prove the facts of his case, certainly the power cannot be made to emerge by putting the enactment in the guise of a rule of substantive law" (p. 329).

To the same effect:

Schlesinger v. *Wisconsin* (270 U. S. 230, 240); *Manley* v. *Georgia* (279 U. S. 1); *Western & Atlantic Railroad* v. *Henderson* (279 U. S. 639, 642); *Railway Co.* v. *Simonson* (64 Kan. 802, 803, 804); *Vega S. S. Co.* v. *Consolidated Elevator Co.* (75 Minn. 308, 312); *Taylor* v. *Anderson* (40 Okla. 316, 319); *Bailey* v. *Alabama* (219 U. S. 218, 236); *Taylor* v. *The State of Georgia* (62 Sup. Ct. R. 415, not yet officially reported); *Weaver* v. *Palmer Bros. Co.* (270 U. S. 402, 414, 415).

These authorities unquestionably dispose of the view expressed by the Circuit Court that "surely no complaint can be heard of measures less harsh than criminal prohibition" (R., p. 142) and show conclusively that although, as stated by the Circuit Court, "in the imposition of penalties Congress has a wide discretion," (R., p. 142) there are

limits even as to civil penalties, imposed by constitutional restrictions.

It should be remembered that as construed by the Circuit Court, the statute, as a matter of law, makes it immaterial whether inside information was actually used on a short swing. But there is no necessary or reasonable relation between the two. "Short swings" are common, though no inside information be available or employed. Indeed, they are usually the manifestation of speculative hunch, rather than predicated on inside information. Accordingly, there is no relationship, ordinarily, between the fact of a "short swing," and the actual use of inside information.

As just stated by this court:

> "Under our decisions, a statutory presumption cannot be sustained if there be no rational connection between the fact proved and the ultimate fact presumed if the inference of the one from proof of the other is arbitrary because of lack of connection between the two in common experience." (*Tot* v. *U. S.*, 63 Sup. Ct. 1241, 1245.)

A fortiori, when as in the case at bar, the presumption is conclusive, and opportunity to explain is denied.

See discussion of the supposed reasons justifying this deprivation of constitutional right, *infra,* pages 58-62.

(B)

INSOFAR AS THE STATUTE DISCRIMINATORILY DEPRIVES THE DEFENDANTS SESKIS AND KAPLAN, TO ANY EXTENT, OF THE USE VALUE OF THE STOCK ACQUIRED BY THEM PRIOR TO THE EFFECTIVE DATE OF THE STATUTE, IT INTERFERES WITH THEIR VESTED PROPERTY RIGHTS.

Edwards v. *Kearzey* (96 U. S. 595); *Gunn* v. *Barry* (82 U. S. 610); *Bank of Minden* v. *Clement* (256 U. S. 126); *Addiss* v. *Selig* (264 N. Y. 274); *Bladney* v. *Sydnor* (172 Mo. 318); *Adair* v. *United States* (208 U. S. 161); *Untermyer* v. *Anderson* (276 U. S. 440); *Tyson & Bro.* v. *Banton* (273 U. S. 418, 429, 430).

It was probably in recognition of the invalidity of any such attempt, that Rule X-16B-1 of the General Rules of the Securities and Exchange Commission, to which we have already referred (*supra*, p. 52), was adopted, incomplete, inadequate and discriminatory, though it is. For, otherwise, the statute would be manifestly illegal and invalid as to acquisitions of stock prior to the effective date of the statute. The exemption thus created by rule,—though it does not go far enough—is in fact, in principle, what is required by law. It should embrace the case at bar.

As we understand the view of the learned courts below, it is to the effect that the restraint accomplished by the statute, for a period of six months—even as to stock acquired before the effective date of the statute—is justified upon the application of the principle that a fiduciary may not deal with the subject of his trust, in competition with his *cestui que trust*. For this authorities are cited (R., pp. 142-144). None of them is in point, for all of them concern themselves with one of two categories—neither of which is presented by this case—i. e. (1) where the fiduciary has preempted for himself the very subject matter of his fiduciary obligation, exemplified—in corporate matters—by what is known as the doctrine of corporate opportunity; (2) where the fiduciary has abused the confidence placed in him, with respect to that which is admittedly the property of the beneficiary.

No such situation is presented here, because it is recognized that a director or officer has the right to buy or sell the stock of his corporation. Such is the settled law of New York: *Hauben* v. *Morris* (255 App. Div. 35; affirmed 281 N. Y. 652); also of Delaware, where the corporation was incorporated; *Cahall* v. *Lofland* (12 Del. Ch. 299); and in the federal courts, as well: *Bisbee* v. *Midland Linseed Co.* (19 Fed. 2nd [C. C. A. 8] 24); *Buchler* v. *Black* (213 Fed. [D. C. W. D. Wash.] 880, 885); *Chenery Corp.* v. *Securities & Exchange Comm.*, 63 Sup. Ct. 454.

Such is the fact recognized by the very statute under consideration, for it does not prohibit sales and purchases, by directors, officers or beneficial owners, of the stock of the

corporation. On the contrary, it recognizes the practice, and has no objection to it, but merely fastens a trust on profits with respect to transactions made, through the use of inside information, and then only, if made within a six-months period.

Nor is it true, as stated by the District Judge (R., p. 77) and reaffirmed by the Circuit Court (R., pp. 141, 142) that as said by the District Judge "These individuals were acting in a fiduciary capacity, exercising powers in trust" (R., p. 77). This court held otherwise in *Security Exchange Commission* v. *Chenery,* 63 Sup. Ct. 454.

In this connection, there is another significant misapprehension on the part of the Circuit Court of Appeals: It says that it is not "a valid objection to the law that it affects stock acquired before the Act. The case is not unlike *Uebersee Finanz-Korporation Aktien Gesellschaft* v. *Rosen,* 2 Cir., 83 F. 2nd 225, certiorari denied 298 U. S. 679, 56 S. Ct. 946, 80 L. Ed. 1400, where the Gold Reserve Act was applied to gold acquired before its enactment. Here, however, the asserted liability seems more an incident of the *holding of office* than of *the ownership of stock* [italics ours]. Defendants continued in office after the passage of the Act, submitted to its registration provisions concerning the stock of their corporation, and, we think, assumed the liability of § 16(b). *Cf. Ferry* v. *Ramsay,* 277 U. S. 88, * * *" (R., pp. 142-143).

We see no relationship at all between the *Uebersee* case and the case at bar. At the time of the *Uebersee* case, the country was faced with one of the most catastrophic emergencies in its history. The power exercised was under the General Welfare clause of the Constitution, the police power, and the specific provisions of the Constitution relating to the national government's control of gold. To compare that situation with the one sought to be remedied by § 16(b) of the Securities and Exchange Act of 1934, is fantastic.

Furthermore, it is not correct to say that defendants' liability was an incident of their *holding office,* rather than of their *ownership of stock.* For the court overlooked

that the penalty inflicted by the statute remained enforcible against defendants, whether they held office or not. It was enough that they were beneficial owners of more than ten per cent of the corporation's stock [15 U. S. C. A. § 78p(a) and (b)], so that, even if they no longer held their offices or their directorships, they would still, under the construction adopted by the Circuit Court, to a substantial extent, be deprived of the use value of their stock, acquired before the enactment of the statute. The asserted liability was clearly an incident of stock ownership.

Furthermore, *Ferry* v. *Ramsay* (277 U. S. 88) does not support the statement made by the Circuit Court of Appeals. For, in that case—no matter how broad the dictum—the fact remains that the defendants were entitled to offer evidence, which the court was bound to consider, as to their good faith. As a result, some of the defendants were acquitted. There was no conclusive presumption creating immutable liability. Moreover, the issue presented, here, is not that envisaged by the dictum of this court in the *Ferry* case, i. e., that there could have been imposed absolute liability.

As just stated by this court, in distinguishing that very case, when the same argument was made:

> "First, it will not serve to sustain the presumption of acquisition after the effective date of the Act, and secondly, it is plain that Congress, for whatever reason, did not seek to pronounce general prohibition of possession * * * but dealt only with their future acquisition in inter-state commerce." (*Tot* v. *U. S.*, 63 Sup. Ct. 1241, 1247.)

So in the case at bar, their may be no presumption as to the sale of stock acquired before the effective date of the statute, nor did the Congress prohibit acquisition and sale of stock by officers, directors, or beneficial owners.

Furthermore in *Ferry* v. *Ramsay* (*supra*) the duty not to accept deposits in an insolvent bank, always existed and was enforced by criminal sanctions. In the case at bar, the right to acquire stock in his own corporation, had always been recognized both for director, and officer, and

also for 10 per cent stockholders. Such was not a mere incident of office, or duty, but a property right entitled to respect. And the fact remains that, in the *Ferry* case, absolute liability was not imposed. The dictum of this court may have been appropriate to the status of the bankers in the *Ferry* case wherein there was involved an existing statutory rule of conduct, enforced by criminal sanctions. It has no application here, wherein there is involved only a property right, untouched by violation of any rule of law. As stated in the *Ferry* case, "there is nothing new in charging a party with knowledge of what is his duty to know * * *" (p. 95). The books are full of instances in which an individual may be convicted of crime though he lacked specific intent. It is quite another thing to charge him with doing what he never did, and to bar him from showing that he never committed the act with which he is charged.

Finally, there is the basic criticism of the remarks of the Circuit Court, which, it seems to us, has cogent force: It is our policy that those in charge of the affairs of a corporation, should be substantial owners of its stock. The right of ownership includes the right of alienation, as and when the owner sees fit and as conditions may seem to him to warrant. When these defendants acquired their stock, such was the law. The remarks of the Circuit Court, as to two lines of decisions on this subject, are not correct (R., pp. 131-132, 141, 142). We know of no case, nor has our attention been invited to any, in which it has been held, by a court applying the common law, that a director, officer or ten per cent stockholder was a strict fiduciary or that in the absence of fraud, actual or constructive he was accountable for his transactions in stock of the corporation with which he was connected. We know of no case in which the corporation was deemed to have any legal or equitable right in the premises (cf. *Securities and Exchange Commission* v. *Chenery Corporation*, 63 Sup. Ct. 454). In making this statement, we merely repeat what was said by this court, in the *Chenery* case. Accordingly, no far-fetched process of theoretical and legalistic rationalization can change the fact that, when the Securities and Ex-

change Act was enacted—if it be construed as it has thus far been—there was a substantial invasion of the property rights of the defendants, who suddenly found themselves unable to use what was theirs, and what, before the statute was enacted, they had a right to use as they saw fit. Even if it be assumed that section 16(b) introduced a new—if fictitious method of measuring non-existent "realized profit," the fact remains that prior to its enactment, measurement of such "realized profit" was by a different and real standard, fixed by the income tax law!

(C)

INSOFAR AS THE STATUTE DISCRIMINATORILY FAILS TO TAKE INTO ACCOUNT WHETHER THE SHARES OF STOCK ACQUIRED PRIOR TO THE SIX-MONTHS PERIOD, WERE THE SHARES OF STOCK SOLD IN THE SIX-MONTHS PERIOD—SO THAT PROFITS ARE COMPUTED ON THE BASIS OF STOCK ACQUIRED WITHIN THE SIX-MONTHS PERIOD, WHICH WAS NOT SOLD DURING THE SIX-MONTHS PERIOD —IT ALSO DEPRIVES THE DEFENDANTS OF VESTED RIGHTS, WITHOUT DUE PROCESS OF LAW.

This proposition applies to all the transactions of each of the defendants, with the exception of 1700 shares bought and sold by the defendant Kaplan—which were the only shares bought and sold within the six-months period.

(D)

INSOFAR AS THE STATUTE DEPRIVES DEFENDANT, KAPLAN, OF THE PROFITS RESULTING FROM THE PURCHASE AND SALE OF THE SAME STOCK, WITHIN THE SIX-MONTHS PERIOD, IT IS A TAKING OF PROPERTY WITHOUT DUE PROCESS, BECAUSE IT IS AN UNREASONABLE RESTRAINT UPON THE RIGHT TO USE SAID PROPERTY.

This proposition concerns itself with the 1700 shares of the defendant Kaplan, as to which it is shown that both the purchases and the sales occurred within the six-months period.

(E)

THE FIXATION OF A PERIOD OF SIX MONTHS, WITHIN WHICH PROFITS MADE FROM SALES AND PURCHASES OF STOCK ARE APPROPRIATED TO THE CORPORATION, IS ARBITRARY AND UNREASONABLE.

We see no reasonable relationship between the purpose of the statute, to prevent speculation in national markets, and the selection of a six-months period, rather than a four-months, five months, or seven-months, period. Furthermore, if the statute be interpreted to do more than exclude inquiry as to intention of holding or replacing stock, we see no relation whatsoever between the fixation of any period and the accomplishment of a purpose to penalize "short swings."

POINT VI.

The statute constitutes an unauthorized delegation of legislative power to the Securities and Exchange Commission, in violation of § 1 of Article I, and Paragraph 18 of § 8 of Article I, of the Constitution of the United States. Of this, defendants have the right to complain.

We regret that both the learned courts below were unable to apprehend this, our contention (R., p. 143, and fol. 242). To us it seems quite plain. Certainly if the statute does not receive the construction for which we contend, appellants are aggrieved, because then they are adjudged by a standard not formulated by the Congress, and different for them, than for those who sold their stock (acquired before the effective date of the statute) within so short a period as six months, whereas defendants did not sell their stock for years. For then, not only does their "intention" of "holding" the stock become immaterial, but even the issue as to whether the sale of that stock shall have the consequences prescribed by the Congress, is left to the whim of the Securities and Exchange Commission! (cf. Rule X-16B-1 quoted at p. 52, *supra.*)

Similarly, the Commission could have made a rule, exempting transactions between directors, as not compre-

hended within the purpose of the act. Its failure to make such a rule, and the grievous consequences upon the substantive rights of citizens, is well-illustrated in this case. For, if the Commission had made such a rule, there can be no question but that the 15,800-share transaction between Seskin and Kaplan would not be comprehended within the statute at all.

A grant of authority which thus actually permits a Commission, not merely to implement a statutory rule, but to define and create substantive exceptions to that rule—with such grievous property consequences—*to the defendants, in this case*—constitutes the delegation of power to legislate, in a very real sense, of which defendants have a right to complain.

See discussion, *supra,* pages 57-62.

For, reading the material portions of the statute (**[**1**]** **[**5**]** and **[**6**]**), in juxtaposition, as follows:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer * * *. This subsection shall not be construed to cover * * * any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

we find that what the Congress declared as the scope of the legislation, is nevertheless, committed to the Securities and Exchange Commission, to emasculate to such extent as the Commission deems is "not comprehended within the purpose" of the subsection. A perfect circle!

It follows, therefore, that it is not correct to say—as did the District Court that "there is no claim of * * * want of exemption" (R., p. 81) and also the Circuit Court—that the Commission "has promulgated no regulation injurious to defendants and we are asked to make an abstract determination upon the face of the statute" (R., p. 144). Claim of "want of exemption" was made, and the Commission has promulgated a "regulation injurious to defendants." The point is that the Commission has been

given *power*, not merely to implement a Congressional enactment by procedural regulations, but to announce, by *regulation* (though "legislation" would be a more accurately descriptive word), as to when the statute does and as to when it does not apply; furthermore, that the Commission has exercised that power, by its Rule X-16B-1 (*supra*, p. 52) to the prejudice of defendants. Accordingly, the Circuit Court was in error when it thought our "request * * * premature," and then contrary to the principle which it purported to apply, did dispense with what it considered to be the absolute necessity for an actual controversy, by announcing that "there is no reason to wait for a future more pointed argument" and thereupon proceeded to validate this aspect of the statute, as if it were presented in the abstract (R., p. 144). The unfortunate fact remains that a "pointed" argument was presented, but its significance not appreciated.

We know of no decision of this court, approving any statute committing such broad and exclusive and unlimited power to a Commission, coupled with a negation of the right to show the true facts, and a complete deprivation of judicial review as to whether those facts justify characterization of the forbidden acts as against the public good.

Even in the Securities Exchange Act of 1934 itself, we have no counterpart of this complete absence of either determining standard or immunity from judicial review, to be accomplished by Subdivision (b) of § 16 (cf. §§ 5, 7, 9, 11, 13, 17, 18, 23, 24, 25, 30). It is only Subdivision (b) of § 16 which, if construed as thus far authorized, neither furnishes a standard, nor gives an opportunity to be heard, nor affords the right to judicial review, and condemns, notwithstanding that there is no reason to condemn. Cf. *Panama Refining Co.* v. *Ryan* (293 U. S. 388, 414, 415, 420, 421, 430); *Schechter Corp.* v. *United States* (295 U. S. 495, 421, 529, 530, 531, 535, 537, 538, 539); *Opp Cotton Mills, Inc., et al.* v. *Administrator of Wage & Hour Division, etc.* (312 U. S. 126).

POINT VII.

The statute, as construed by the District Court, constitutes an unauthorized invasion into transactions which are not a part of interstate commerce, as contemplated by Clause 3 of § 8 of Article I of, and the Tenth Amendment to, the Constitution of the United States.

Schechter v. *United States* (295 U. S. 495, 542, 543, 544, 547, 548).

It will be noted, in this connection, that, whereas the proof shows that the corporation's subsidiaries were engaged in interstate commerce, there is lacking any stipulation or any evidence that any of the sale or purchases of stock were made in interstate commerce (Ex. 1, par. 4). *Sorrells* v. *United States* (287 U. S. 435, 466-8); *Holy Trinity Church* v. *United States* (143 U. S. 457); *Louisville Gas & Electric Co.* v. *Coleman* (277 U. S. 32, 37); *Broadnax* v. *Missouri* (219 U. S. 285).

SECTION III.

(Treating of Fees.)

POINT VIII.

Delendo did not receive any benefit, but, on the contrary, suffered a distinct and manifest disservice. Its pending dissolution was and is being delayed, and the right of its directors, to exercise their own judgment for the corporation, has been usurped by irresponsible stockholders, unconcerned with the corporation's welfare.

The opinion of the Circuit Court closes with the observation, as to counsel fees, that "the allowance must not be too niggardly" (R., p. 145). But such was not our point, and we do not urge any such point here.

In the Circuit Court, we argued that there should not be any allowance of fees at all, in view of the lack of any benefit to the corporation, and consequent disservice to the corporation. We argued, further, that, in any event, there should be an allocation of the fees, proportionate to the

distributive shares of the insignificant stockholders who were plaintiffs in the action—especially in view of the fact that the corporation was in dissolution. We did not argue that the fees should be reduced.

Now, directing ourselves to the proposition which we urge—which is not the proposition discussed by the Circuit Court:

It is inconceivable that any sane business man, under the circumstances presented in this case—with the corporation dissolved, liquidation in process, and distribution to stockholders necessarily delayed, entailing consequent expense (fols. 299-305)—would have authorized the bringing of this suit for the insignificant sums involved, i. e., about two cents per share, to redress what could not under any circumstances be deemed a wrong to the corporation, but in fact was exemplary conduct on the part of its fiduciaries. We find nothing in the statute which requires that such a course be taken, even though it be to the detriment of the stockholders, and not to their advantage.*

If the substantive law of New York be applicable, on the issue of what is the proper business discretion of the corporation's directors—and we submit that it should be—it is quite settled that a valid claim of the corporation may be waived, if it be in the corporation's interest to do so (*Koch* v. *Estes,* 146 Misc. 249, affirmed 240 App. Div. 829, affirmed 264 N. Y. 480; *Koral* v. *Savory,* 276 N. Y. 215; *Levine* v. *Behn,* 174 Misc. 988, affirmed 262 App. Div. 729, leave to appeal denied, 262 App. Div. 845). The fed-

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*In the Circuit Court, the Government thought that it was "anomalous that Delendo should be represented by counsel for the individual defendants" (footnote, p. 4). Why not? The real attorneys for Delendo, *pro hac vice,* are the imposing array of Government counsel, and plaintiffs' counsel. Delendo, in understandable sympathy with its management—who have rendered loyal service—would have nothing of a judgment which, as the record shows (fols. 299-306) is prejudicial to Delendo, and works injustice to its directors and officers. An example—which the Securities Exchange Commission should be the first to appreciate—of corporate morality and decency!

eral law is to the same effect: *Corbus* v. *Gold Mining Co.* (187 U. S. 455, 463), *United Copper Co.* v. *Amalgamated Copper Co.* (244 U. S. 261, 263).

The statute merely authorizes a suit in the interest of the corporation. It does not require one to be brought, come what may. Since the statute contemplates that the action be brought in the name of the corporation, presumably this means that the action must be brought for its benefit, and not to its detriment, merely so that the attorneys of two stockholders (having but a $3 interest in the result) owning 150 shares out of 800,000, may earn fees. We assume, therefore, that equitable principles apply. Under such equitable principles, whether those reflected in the law of the forum where the action is brought (cf. *Erie R. R. Co.* v. *Tompkins,* 304 U. S. 64) or of the federal courts, or under the authorities generally—particularly in view of the fact that the corporation is in dissolution—the relief granted should have been distributive, i. e., allocated to the two stockholders owning 150 shares out of 800,000, and the fees of their attorneys should have been measured accordingly (*People* v. *Ballard,* 56 Hun 125, 134 N. Y. 269; *Harris* v. *Rogers,* 190 App. Div. 208; *Alexander* v. *Quality Leather Goods Co.,* 150 Misc. 577, 581; *Jacobellis* v. *Prudential Ice & Coal Corp.,* 269 N. Y. 632; *Jackson Co.* v. *Gardiner Co.,* 200 Fed. [C. C. A. 1st—1912] 113; *Backus* v. *Brooks,* 195 Fed. [C. C. A. 2nd—1912] 452; *Sale* v. *Ambler,* 335 Pa. 165, 170-1; *Bailey* v. *Jacobs,* 325 Pa. 187; *Commonwealth Title & Trust Co.* v. *Seltzer,* 227 Pa. 410; *Jenkins* v. *Bradley,* 104 Wisc. 540; *Eaton* v. *Robinson,* 19 R. I. 146). Yet, the decision of the learned courts in this case, commends and rewards plaintiffs—not for a benefit received by the corporation—but for an actual detriment, inflicted upon it and its stockholders.

Conclusion.

We have shown that the statute was never intended to do anything but prevent the use of inside information, on a "short swing" and that the construction adopted by the

Securities and Exchange Commission is not in accord with either the letter of the statute or its spirit—or, for that matter, with the intention of the framers of the statute, as exhibited in the Senate hearings.

Even assuming the validity of the statute, and, again, assuming that its purpose was to appropriate to the corporation the profits of transactions made within six months—without inquiry as to whether the beneficial owners involved employed inside information—it is, nevertheless, quite clear that the profit so appropriated must be actual "profit realized," giving due recognition to each transaction, and computing such profit upon the yield afforded on the sale or purchase of the particular stock forming the subject matter of the transaction.

On this basis, there could not be any judgment against Seskis, and a judgment of only $23.91 against Kaplan. For, as to Seskis, as we have shown, there were no transactions of this character. And, as to Kaplan, though there were transactions of this character, totalling 1700 shares, a recognition of the principle stated shows that only on one transaction was there a profit of $23.91.

Furthermore, approaching the same problem from another point of view: As to the defendant Seskis, the 15,800 shares which he delivered to Kaplan should not be considered a transaction within the statute, any more than was the same transaction, from the point of view of Kaplan. On this basis, no judgment could be rendered against Seskis either.

And, looking at the problem from still another point of view: Since the statute should not be construed as having application to any shares of stock acquired prior to the effective date of the statute, a judgment could not be entered against Seskis, except as to 4500 shares which were acquired in 1937. This would, in any event, reduce the judgment as against Seskis to $2,812.50 (fol. 244).

But we think it should be unnecessary to consider these more specific grounds, just recited, for the reason that the statute should be construed as lacking any application at all to the situation in the case at bar, since, not only

was there lacking any abuse of inside information, but, in fact, there was no inside information which could be used.

And, if all of these arguments as to construction of the statute, nevertheless should be found wanting, it follows, necessarily, that the statute is unconstitutional, for the reasons stated.

In any event, no attorneys' fee should have been allowed.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers of granting a writ of certiorari, and thereupon to review and reverse the judgment and decision below.

Respectfully submitted,

JAY LEO ROTHSCHILD,
Solicitor for Petitioners.

July 14, 1943.

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 197

DELENDO CORPORATION (FORMERLY OLDETYME DISTILLERS CORPORATION), I. J. SESKIS AND HENRY C. KAPLAN, PETITIONERS

v.

PHILIP SMOLOWE AND M. WILLIAM LEVY, SUING ON BEHALF OF THEMSELVES AND AS STOCKHOLDERS AND FOR THE BENEFIT OF ALL OTHER STOCKHOLDERS OF DELENDO CORPORATION SIMILARLY SITUATED WHO MAY ELECT TO COME IN AND CONTRIBUTE TO THIS ACTION

UNITED STATES OF AMERICA, INTERVENOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (R. 69–84) is reported in 46 F. Supp. 758. The opinion of the circuit court of appeals (R. 127–142) is not yet reported.

546657—43——1

JURISDICTION

The judgment sought to be reviewed was entered June 25, 1943 (R. 143). The petition for a writ of certiorari was filed July 23, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether, in an action under Section 16 (b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. 78p (b)), it is necessary for the plaintiff to show that the defendant obtained information by reason of his relationship to the issuer, or made unfair use of information so obtained.

2. Whether the application of Section 16 (b) depends upon the use of identical certificates in the purchases and sales upon which liability is predicated.

3. Whether the court below adopted the proper method of computing the measure of recovery in an action under Section 16 (b).

4. Whether Section 16 (b), as construed by the court below, deprives the petitioners of due process of law.

5. Whether Section 16 (b), as construed by the court below, is a valid exercise of Congressional power under the commerce clause of the Constitution.

6. Whether the exemptive power conferred upon the Securities and Exchange Commission by the last sentence of Section 16 (b) involves an unlawful delegation of legislative power.

7. Whether the allowance of fees and disbursements to counsel for the plaintiffs was proper.

STATUTE INVOLVED

Section 16 (b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. 78p (b)) reads as follows:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner,[1] director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, di-

[1] The term "such beneficial owner," as here used, refers back to the phrase in Section 16 (a): "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange." The term "equity security" is defined in Section 3 (a) (11) of the Act as meaning, among other things, "any stock or similar security."

rector, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

STATEMENT

The consolidated actions which resulted in the judgment sought to be reviewed are the first actions brought under Section 16 (b) of the Securities Exchange Act of 1934. That section, briefly summarized, provides that officers, directors, and 10% stockholders of issuers with securities listed and registered on a national securities exchange shall surrender to the issuer any profit

they may realize from any purchase and sale, or any sale and purchase, of the issuer's equity securities within any period of less than six months. The section provides further that suit to recover such profit may be instituted by the issuer, or, in its default, by the owner of any security of the issuer.[2]

The two actions below were brought by stockholders of Delendo Corporation (hereinafter referred to as Delendo) to recover profits realized by the petitioners Seskis and Kaplan from their transactions in the common capital stock of Delendo during the period from December 1, 1939, to May 31, 1940. Seskis was the president and Kaplan the vice president of Delendo; in addition, each was a director and the beneficial owner of more than 10% of Delendo's stock (R. 53–54). Delendo, a Delaware corporation with its office and principal place of business in the State of New York, was a holding company owning the stock of various subsidiary companies engaged in the whiskey business, which was carried on by these subsidiaries in interstate commerce (R. 52–53). Delendo's stock was registered under the Securities Exchange Act as a security listed on the New York Curb Exchange, which itself was a national securities exchange registered as such under the Act (R. 54). Except for the holdings of the petition-

[2] Relevant qualifications and amplifications of this summary of the section will be specified below in the Argument.

ers Seskis and Kaplan, the stock was widely held, by many separate stockholders scattered throughout the United States and in foreign countries (R. 54).

During the six months' period involved, Seskis purchased 15,504 shares of Delendo stock for $25,150.20 and sold 15,800 shares for $35,550, and Kaplan purchased 22,900 shares for $48,172 and sold 21,700 shares for $53,405.16.[3] Some of the purchases and sales were made through brokers on the New York Curb Exchange; some were made by private transaction, without any intermediary and without any use of the mails or of interstate commerce. Except as to a very small percentage, the certificates delivered by each in consummation of sales were not the same certificates as those received in consummation of purchases made during the six months' period (R. 55–62).

Action in respect of these transactions was first instituted by the respondent Smolowe (R. 3–7). The answer to Smolowe's complaint drew in question the constitutionality of Section 16 (b), and upon notification thereof the United States sought leave to intervene, under the Act of August 24, 1937 (28 U. S. C. 401) and Rule 24 of

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[3] The proper method of computing the amount of "profit realized" on these transactions, for the purposes of Section 16 (b), is one of the questions presented by the petition for a writ of certiorari.

the Federal Rules of Civil Procedure. Leave to intervene was granted,[4] and the United States thereupon became a party to the action, and filed a pleading in intervention (R. 27–31). Intervention was later similarly asked and granted in the action brought by the respondent Levy (R. 33), and the two actions were thereafter consolidated (R. 33–35).

As the facts were stipulated in the district court, the only questions raised were questions of law. The district court entered judgment in favor of the respondents. The court held that Section 16 (b), as applied to the facts of this case, involved no denial of due process of law to petitioners (R. 78–80), constituted a valid exercise of the commerce power conferred upon the Congress by

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[4] R. 24–26. The right of the United States to intervene was contested by the petitioners. The opinion of the district court disposing of the objections is reported in 36 F. Supp. 790. The order permitting intervention limited the intervention "to presenting evidence and arguments in support of the constitutionality" of Section 16 (b). However, the order further expressly provided that "*the foregoing limitation is without prejudice* to the contention of the United States that the issues of construction and constitutionality of the statute herein drawn in question are so interwoven that the right to be heard on the issue of constitutionality includes the right to be heard on the issue of construction" (R. 25; words emphasized in the foregoing quotation were inadvertently omitted in the printed Record). Thereafter, counsel for the petitioners in open court expressed their willingness that the United States be heard on all issues of law involved, whether concerning construction or constitutionality.

546657—43——2

the Constitution (R. 80–81), and involved no unconstitutional delegation of legislative power to the Securities and Exchange Commission (R. 81). The court further held (1) that in an action under Section 16 (b) it is unnecessary for the plaintiff to show that the defendants made actual unfair use of information which might have been obtained by reason of their relationship to the issuer (R. 75), and (2) that in determining the amount of profit recoverable under Section 16 (b) by reason of a purchase and sale, or sale and purchase, within the six months' period, the identity of the certificates purchased or sold is immaterial (R. 75).

In computing the measure of recovery, the district court adopted a rule later called by the circuit court of appeals (R. 138) the "lowest price in, highest price out" rule.[5] On the basis of this

[5] R. 82. The district court expressly adopted the method of computation which the Securities and Exchange Commission, in a brief filed as *amicus curiae*, proposed in the following terms:

"* * * the plaintiff in any case under Section 16 (b) is entitled to list in one column all purchases made during the period in respect of which he seeks relief, and in another column all sales made within the same period. As a measure of the recovery to which he is entitled, he may start by matching off against each other the shares purchased at the lowest price during the period and an equal number of shares sold at the highest price or prices during the period, the measure of recovery in respect of this 'purchase and sale' being the difference between the two prices. Then, the purchase price of the shares purchased at the next lowest price may be similarly matched off against the highest sale price of any remaining

rule, the district court rendered judgment against petitioner Seskis for $9,733.80 and against petitioner Kaplan for $9,161.05, with costs in each instance. In addition, the district court allowed to plaintiffs' counsel $3,078.98 as counsel fees and disbursements, to be paid out of the sum recovered by Delendo from the individual petitioners.

On appeal, the circuit court of appeals accepted the conclusions of the district court on all points, and affirmed the judgment (R. 127–142).

ARGUMENT

In this case petitioners raise questions as to the validity and construction of Section 16 (b) of the Securities Exchange Act of 1934. These questions are of undoubted importance. But, of these, petitioners have not stressed the commerce question (see petitioners' brief, p. 66), and the delegation and due process points are without substance (see the opinions below at R. 78–81, 139–141, and *infra,* pp. 14–16, 17–18). On the questions of statutory construction, there is no conflict of decisions; indeed, this is the only case involving them. Although we do not oppose the issuance of the writ, we believe the case has been correctly decided, and we discuss the questions presented in aid of a

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equal number of shares sold during the period. The same process may be continued until all shares purchased have been matched off, so far as possible, against an equal number of shares sold at higher prices. The gross recovery is the sum of the several differentials thus determined."

determination whether further review is warranted.

1. Although the record establishes that inside information was available to the individual petitioners which might have had substantial bearing upon their determination to buy or to sell their company's stock (R. 42–45), there is no showing that either of them actually made unfair use of any such information.[6] The court below correctly held that no such showing is required by the statute.

Generally speaking, the Securities Exchange Act of 1934 is designed to impose a measure of regulatory control upon the national securities exchanges of the country, and upon trading practices in securities listed and registered on such exchanges. The main purpose of the Act is to protect the investing public by insuring that the securities exchanges of the country shall maintain free, fair, and open markets for the buying and selling of securities at honest prices, and by assur-

[6] The United States offered certain proof as to the circumstances surrounding petitioners' trading transactions (R. 42-45). It was stipulated (R. 45) that the United States would not contend, and the United States does not contend, that the petitioners in their transactions of purchase and sale acted in bad faith, or unfairly used any information which they had obtained. This, however, was the limit of the stipulation. Petitioners are in error in asserting in their brief (p. 31) that "the record, in this case, shows that temptations, if there were any, were resisted", and that it was a "stipulated fact that defendants did not use inside information and acted in utmost good faith."

ing to investors in these markets accurate and adequate information on which they can form intelligent judgments of values.

Section 16 (b) of the Act implements these general purposes by insuring to investors that the information to which they are entitled, and which the Act purports to furnish them, shall not be made useless to them by the operations of insiders who have had an opportunity to take full advantage of it ahead of time for their own personal benefit. To this end, Section 16 (b) creates in any issuer with equity securities registered under the Act, and in its security holders, the right to recover from officers, directors, or 10% stockholders—in short, "insiders"—any profits which the insiders may make by trading operations in such equity securities within a period of six months.

Liability under Section 16 (b) is based upon the profit from "any purchase and sale, or any sale and purchase" within the statutory period. There is no requirement in the language of the section that a plaintiff establish by proof that inside information had actually been secured by the insider, or if secured had been put by him to unfair use. The preamble to the section states that its sanctions are imposed: "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his rela-

tionship to the issuer * * *." This language, while it declares the purpose of the Congress in enacting the section, does not support the position urged by the petitioners, but rather the contrary; their construction would disregard the use of the conditional phrase "which may have been obtained," and read it as though it were a positive "has been obtained." Furthermore, the petitioners' proposed construction would impose upon plaintiffs a burden of proof which could rarely, if ever, be met, and would largely nullify the purpose of the section. The facts as to an insider's possession of inside information, and as to his unfair use of it, are facts which by their nature would not ordinarily be available to public security holders.

2. The court below correctly held that in determining the amount of profit recoverable under Section 16 (b) the identity of the particular certificates used in a purchase and sale, or a sale and purchase, is immaterial. The language of the section does not require, or suggest, that the purchases and sales must involve identical certificates; rather, it refers to profit realized "from any purchase and sale, or any sale and purchase, of any equity security" of the issuer. The evil struck at by Section 16 (b) is the evil of short-swing, speculative trading by insiders. If the impact of the section were confined to instances involving the same certificates in both purchase

and sale, or sale and purchase, the section would be ineffectual. In purchases followed by sales, insiders would ordinarily be able, as were the petitioners in this case, to draw upon their original holdings so as to use for their sales certificates different from those they had acquired in their purchases within the six months' period. In sales followed by purchases, the statute would be for all practical purposes meaningless, at least in the usual market transaction, since the likelihood of reacquisition of the certificates originally sold would be negligible.

The "first-in, first-out" rule, proposed by petitioners, was likewise properly rejected by the court below. This rule, adopted as a convenient device in tax cases, has no reasonable application to the type of situation covered by Section 16 (b). Its use finds no basis in the language of the section, and would be inconsistent with its purposes. The language of the Act permits the matching of any purchase and any sale during the six months' period, and the "lowest price in, highest price out" rule accepted by both courts below is the only method which, consistently with the language of the section, gives full effect to its purpose of deterring insiders from speculating in their knowledge of the affairs of their corporation. The legislative history upon which petitioners rely is, as the circuit court of appeals held (R. 134), entirely consistent with the interpretation adopted.

3. Section 16 (b), as construed by the court below, involves no want of due process of law. The Securities Exchange Act of 1934 as a whole was adopted by the Congress only after extensive investigation of stock exchange practices,[7] and upon a considered finding, expressed in Section 2 of the Act, as to the necessity, in the public interest, of regulation and control not only of stock exchanges and transactions in securities commonly conducted thereon, but also of practices and matters relating thereto, "including transactions by officers, directors, and principal security holders." This finding, in the absence of proof to the contrary—of which of course there is none[8]—must be taken as true, unless it is completely irrational or arbitrary. *United States* v. *Carolene Products Co.*, 304 U. S. 144; *South Carolina Highway Department* v. *Barnwell Bros.*, 303 U. S. 177; cf. *Olsen* v. *Nebraska*, 313 U. S. 236. Section 16 (b), as a device to deter insiders from speculating in their knowledge of their corporation's affairs, is a reasonable adaptation of common law principles which have long been accepted by the courts in comparable situations. Cf. *Woods* v. *City National Bank*, 312 U. S. 262; *Meinhard* v. *Salmon*, 249 N. Y. 458, 164 N. E. 545 (1928).

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[7] See Sen. Rep. No. 1455, 73d Cong., 2d Sess. (1934).

[8] The United States, in its pleading in intervention in this case (R. 27–31), alleged at length the facts underlying the Congressional finding. Although the petitioners interposed a general denial (R. 33), no proof was introduced on the issue.

The specific substantive provisions of Section 16 (b) are likewise reasonable, and involve no denial of due process of law. The preamble to the section does not create "a conclusive presumption," or deprive petitioners of a right to prove relevant facts. It does no more than state the purpose of the Congress in enacting the section, in accordance with the legislative custom to insert declarations of purpose as an aid to constitutionality.[9] That the Congress, in the exercise of its authority to deter abuses of the facilities of national securities exchanges, elected to bring within the scope of Section 16 (b) transactions which in a particular case might involve no element of unfairness is no denial of due process. "Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction." *Securities and Exchange Commission* v. *Chenery Corporation,* 318 U. S. 80, 92. Even the prohibition of all such transactions by corporate insiders would not have been unreasonable. Cf. *Booth* v. *Illinois,* 184 U. S. 425; *Otis* v. *Parker,* 187 U. S. 606; *Purity Extract Co.* v. *Lynch,* 226 U. S. 192.

There is no merit in the argument of the petitioners that the statute deprives them of due proc-

[9] The preamble also serves to assist the Securities and Exchange Commission in the exercise of its rule-making authority under the last sentence of Section 16 (b).

ess because it "retroactively" deprives them of profit from the sale of shares acquired before the passage of the Act (Pet. Br. pp. 57–62) or acquired before the beginning of the six months' period (Pet. Br. p. 62). Even if the Act were regarded as affecting property acquired before its passage, it would not be invalid; this Court has frequently held that "a statute is not retroactive merely because it draws upon antecedent facts for its operation."[10] In this case Section 16 (b) is being applied to petitioners because of their conduct during a six months' period long after the Act was passed.

4. The court below correctly held that Section 16 (b), even though it applies to transactions not effected on a national securities exchange, or otherwise by means of interstate commerce, is a proper exercise of the commerce power. The Act, as noted above, was based upon thorough investigation and competent legislative findings. Section 16 (b), read in the light of the findings in Section 2, is a declaration by the Congress that all short-swing trading by insiders in securities listed on national securities exchanges affects interstate commerce, regardless of whether the transactions are themselves carried on in interstate

[10] *Lewis* v. *Fidelity & Deposit Co.*, 292 U. S. 559, 571; *Mugler* v. *Kansas*, 123 U. S. 623; *New York Cent. R. R.* v. *United States*, 212 U. S. 500; *Jacob Ruppert* v. *Caffey*, 251 U. S. 264, 301; *Samuels* v. *McCurdy*, 267 U. S. 188, 193; *Mulford* v. *Smith*, 307 U. S. 38, 51.

commerce. The securities involved here were listed on a national securities exchange. The determination by the Congress that regulation of insider trading in listed securities can be effective only if it covers purchases and sales of such securities wherever made, is a reasonable determination, not arbitrary or capricious, but in close conformance with observable realities. This determination should not be disturbed by the courts. In passing on the validity of commerce legislation regulating intrastate transactions, the only function of the courts is to determine whether Congress has chosen "means reasonably adapted to the attainment" of a legitimate commerce objective. *United States* v. *Darby,* 312 U. S. 100, 120–121; *Wickard* v. *Filburn,* 317 U. S. 111, 124.

5. The court below correctly held that the exemptive power conferred upon the Securities and Exchange Commission by the last sentence of Section 16 (b) involves no unlawful delegation of legislative power. Insofar as it is a delegation of power, it is guided by the clearly adequate standard that the exemptive regulations shall be consistent with the expressed purposes of the section. *United States* v. *Rock Royal Coop., Inc.,* 307 U. S. 533, 574. The constitutional propriety of carefully defined and limited exemptive provisions, designed to provide flexibility to meet special or unforeseen cases, is well established. Cf. *United States* v. *Shreveport Grain & Elevator Co.,*

287 U. S. 77, 85. In any event, the exemptive power has not operated in any way to the injury of petitioners, and they have no standing to criticize it. See *Gorieb* v. *Fox*, 274 U. S. 603.

6. While believing that the court below was warranted in making an allowance of counsel fees and disbursements to plaintiffs' counsel out of the sum recovered by the corporate defendant, the United States expresses no view as to the propriety of the particular amount allowed.

CONCLUSION

The decision of the court below presents no conflict of decisions. While certain of the issues present important questions of federal law which have not been decided by this Court, the decision of the court below seems clearly correct on all questions of construction and constitutionality, and if permitted to stand as a definitive statement of the law will serve as an adequate guide to the future conduct of persons subject to Section 16 (b).

Respectfully submitted.

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AUGUST 1943.

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